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Supreme Court of the United States
OCTOBER TERM, 1984

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC.,
a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

APPENDIX TO JURISDICTIONAL STATEMENT

VOLUME I
Pages CA-1 to CA-524

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September 21, 1984

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This Appendix is submitted by the Appellants, which consist of Central Jersey Industries, Inc. and its subsidiaries, The Central Railroad of Pennsylvania, the Communipaw Central Land Company, the Dover and Rockaway Railroad Co., the Mt. Hope Mineral Railroad Co., the Wharton and Northern Railroad Company and the Bayshore Connecting Railroad. There are no other subsidiaries or affiliates of any of the Appellants except for certain wholly owned subsidiaries of Central Jersey Industries, Inc.

APPENDIX A

Appendix A

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1976

Special Court—Misc. No. 76-1

Filed June 16, 1976, James F. Davey, Clerk

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT[1]

MEMORANDUM AND ORDER DIRECTING PRELIMINARY PROCEEDINGS FOR THE DETERMINATION OF GENERAL PRINCIPLES UNDER §§ 303 AND 306 OF THE ACT

I. HISTORICAL BACKGROUND AND GENERAL CONSIDERATIONS.

In this Court's opinion of September 30, 1974, 384 F. Supp. 895 at 926 n.53, we said that, as we then envisioned, our initial task after the conveyances provided in § 303 of the Act, "would be, after suitable briefing and argument, to set the principles for valuing the properties conveyed." These principles would then be applied to specific properties by a number of special masters, whose decisions we would review. It would have been premature to attempt to analyze just what issues would benefit from such advance determination, and we likewise did not address ourselves to such questions as whether an initial setting of guidelines would require discovery or the taking of evidence.

The extensive amendments made in Title VI of the Railroad Revitalization and Regulatory Reform Act of 1976 have considerably augmented the difficulties of what already was probably the most gigantic task ever confided to a court. The added

problems arise in considerable part from the Amendments' creation of a new form of security which is to comprise a part of the consideration payable to railroads that have transferred property to ConRail, namely, "certificates of value" (CV's), § 306, which are to be redeemed by USRA not later than December 31, 1987, § 306(c)(1); the CV's are guaranteed by the Secretary of Transportation, constitute general obligations of the United States, and carry the pledge of its full faith and credit, § 306(a). A separate series of CV's is to be issued to each transferor, § 306(b). Critical to ascertainment of the redemption price is our determination, § 306(c)(4), of the "base value" (BV) of each series. This is computed by determining the "net liquidation value" (NLV), to which the transferor may be entitled by virtue of transfer of property to ConRail, subtracting the value of other benefits provided under the Act (VOB), adding compensable unconstitutional erosion (CUE), and finally adding interest compounded annually at the rate of 8% per annum; to get the BV of each certificate, the figure just obtained is divided by the number of certificates in the series. The formula, omitting the interest item and the final division, thus is:

$$BV = NLV - VOB + CUE$$

A principal problem is that this new concept was superimposed on the concepts of "public interest," "fair and equitable," and "constitutional minimum" in § 303(c) without any clear indication in the statute itself, as distinguished from the legislative history, what Congress considered was the relationship of the securities issuable to the transferors[2] as prescribed by § 306 and the standards laid down in § 303.[3]

The added complexities created by the 1976 Amendments seemed to us to heighten the necessity for this Court to make as many determinations of law as possible, at least in a preliminary fashion, before putting the special masters to work. Putting aside for the moment the secondary debtors of Penn Central

(PC) and the non-bankrupt lessors, we have seven primary debtors, and it is apparent that more than one special master will be required in the case of Penn Central (PC) and perhaps in that of the Erie-Lackawanna (EL) if undue delay is to be avoided;[4] realistically therefore when we speak of special masters, we are thinking in terms of at least ten.

Because of such considerations the Court, on March 9, 1976, sent a letter to all members of the Acting Liaison Committee which the Court had appointed, outlining the Court's tentative views of what legal issues required decision and raising a number of procedural questions. This led in turn to the Court's order of April 26, 1976, prescribing a procedure whereby all parties were invited to file statements commenting on the issues and the structure of this proceeding, with an opportunity to file answers responding to the statements of others. The order also set forth a procedure whereby persons not named as parties might apply for leave to intervene. The Court has now reviewed these statements and answers, many of which have been exceedingly helpful.

While substantially all the comments recognize the existence of some questions which the Court may now determine after appropriate briefing and argument, most take a rather parsimonious view on this score. Although professing to recognize the necessity of providing the special masters with guidelines, many of the proposals seem to be that the special masters shall take evidence on whatever theory passing the lowest threshold of rationality may be offered to them.[5]

We think this would produce utter chaos. If a transferor or security holder[6] is allowed to offer evidence based on a certain theory of value, the Government parties[7] could not afford simply to argue that the theory was wrong; they would be obliged to cross-examine and offer rebuttal on the detailed application of the theory since for aught that would appear we might adopt it. Similarly the special masters would be obliged to make factual findings with respect to all theories even though we were to relieve

them of the task (which we would reserve for ourselves) of choosing among them.

While we respect the zeal displayed by the parties, there are other considerations that must be borne in mind. The PC has already been in reorganization for six years, the CNJ still longer, and the New Haven since 1961. It has now become apparent that a good many months will elapse before the special masters can profitably be put to work in any event. It is impossible to predict how long their labors will take under the best of circumstances, and if we had not already determined the proper principles we would be at the mercy of the slowest, since otherwise our determination in the earlier cases would govern the later ones without having afforded the parties in such cases a hearing. After the masters' reports will come our own consideration and decision on a mammoth record, and appeal to the Supreme Court, and possibly proceedings in the Court of Claims. Until all these steps, save perhaps the last, have been completed, the reorganization courts will be unable to make meaningful progress with their individual plans and the expensive administration of these estates, some of which are understood to be on the verge of actual insolvency, must continue. Indeed we have considerable doubt whether, under the procedures proposed by some parties, the CV's could be valued by December 31, 1987, their redemption date. The legal and other expenses of the litigation in this Court will be tremendous in any event and would become even more staggering and a legitimate subject for public concern if the litigation were protracted beyond the necessities of the case. Given all this and the fact that no procedure can produce a mathematically perfect result, it behooves all concerned with this proceeding to cooperate in devising procedures that will shorten the interval before final decision to the the full extent compatible with essential fairness. We believe it is possible to devise procedures that will enable us to decide a large number of basic questions before the special masters go to work, although there are other matters on which there is no need for an early decision. In

saying this we are conscious of the risk that by making some preliminary rulings we may be courting reversal by the Supreme Court and the need of starting all over again; we simply think the danger of this to be less serious than the consequences of letting the special masters proceed as some of the parties have proposed, see fn. 5. Indeed, as this Memorandum progresses, the need for our making a considerable number of preliminary rulings will become even more evident.

We add one final prefatory note. The complexity of this case, as revealed by the statements submitted to us, has convinced us that the many preliminary issues that must be considered are best addressed in several separate units. What follows is a delineation of these units, with instructions to the parties and intervenors as to how they should proceed as to each. For the convenience of the parties we annex a schedule of the dates fixed for various steps in these preliminary proceedings.

II. Questions Which the Court can now Decide Without Presentation of Factual Material.

There appears to be almost complete agreement that the Court may now decide, without taking any evidence, what we characterized in our March 9, 1976 letter as the "first set" of § 303 issues; indeed, there appears to be a fair amount of agreement how we should decide them. Accordingly we shall set these and some other matters for briefing and argument in accordance with the schedule outlined below:

Initial briefs - August 23, 1976
Answering briefs - September 21, 1976

Time requests for oral argument shall be filed with the answering briefs. In this and all other cases dealt with in this Memorandum and Order, the parties shall arrange for joint briefing and argument to the maximum extent possible and shall keep the length of

briefs to the minimum. After studying the briefs and time requests, the Court — perhaps after a pre-argument conference — will advise the parties of the time, place and organization of the argument.

In light of the statements, we deem it desirable to sharpen the issues as follows:[8]

(1) *"Public interest."* The first question raised in our March 9 letter concerned the nature of our responsibility under § 303(c)(1)(A) to determine whether the transfers and conveyances "are in the public interest . . . ," especially in view of the description of judicial review in the second sentence of § 209(a) and the statement on p. 137 of the Conference Report of January 23, 1976. Several parties suggest that we need only determine that Congress had a rational basis for enacting the Rail Act and make no suggestion that it did not. If that is right, this issue can be regarded as substantially out of the case. However, two other views emerge from some of the statements.

One of these is that the "public interest" test requires us to pass on the viability of ConRail. At the moment we do not understand why we need to do this, just how we should go about it, or what we could do if we decided in the negative since a major reconveyance does not appear to be feasible. If any parties espouse this view, they should develop it in briefs.

The other such view is that although the "public interest" test may have little or no significance for the main body of the conveyances, it may require us to pass on the inclusion of certain peripheral properties or to decide whether, if the Act be regarded as a condemnation statute, certain properties were taken for something other than a public use.[9] It is hard to consider the question *in vacuo*. Any transferor or security holder allowed to intervene who asserts this position shall include in its brief illustrative statements of the properties in respect of which sum a claim is made and the supporting reasons; the answer of the Government parties need meet such claims only with respect to legal issues since

evidence would have to be taken if the Court were to decide there is need to pursue the matter further. In other words, what the Court needs is factual material sufficient to enable it to decide whether, if any such claims are made, they have sufficient legal merit to require further development of the facts.

(2) *Fair and equitable.* The second question propounded in the March 9 letter concerned the construction of the "fair and equitable" language in § 303(c)(1), especially in view of the facts (a) that if the consideration is "fairer and more equitable than is required as constitutional minimum," § 303(c)(3) requires us to eliminate the excess, and (b) that if the consideration were less than the constitutional minimum, it would not be fair and equitable.

Almost all, perhaps all, the statements seem to agree that the fair and equitable language serves no significant function in the determination of the value of any particular property, although several parties (including the Government parties) have suggested that this language may have a bearing on the allocation of ConRail's Series 3 Preferred and common stock. There is no need to rule on the latter suggestion now, since it will not be a matter for immediate consideration by the masters. Accordingly the Court will consider the "fair and equitable" issue to have been removed from the process of valuing the properties of individual estates or other transferors unless this is raised in the briefs to be filed as above indicated; any person taking such a position shall state with precision and not merely in conclusory terms how the "fair and equitable" test differs from the constitutional minimum test with respect to valuation in the context of the Act as it now stands.

The March 9 letter also raised the question whether the Court was bound to ascertain by what amount the consideration was less than fair and equitable and, by the same token, less than the constitutional minimum, even though the Court might have no effective way of remedying the defect. Further consideration had

led us to an affirmative answer even before receipt of the statements; several of these suggest this and none opposes. Accordingly there is no need to brief this issue.

We pass now to certain other questions of law which we believe the Court may now be able to decide, without taking evidence. These should be briefed and argued in accordance with the schedule set out on page [CA-5].

(3) *Reorganization vs. eminent domain statute.* Although not raised in the March 9 letter, a question lurking in the case is whether the standard of valuation[10] should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both. At the moment the Court does not perceive that it should be. Any parties taking a different view should include arguments on the score in their briefs. Some parties also intimate that there may be different procedural requirements if the Act is regarded as an exercise of eminent domain; any party taking this view should brief it.

(4) *Reckless or deliberate disregard.* We include this item in the list, although it may not fit the caption. In the last paragraph of the March 9 letter, we stated we would "like to be promptly advised whether USRA, the United States, ConRail, or any other party represented on LC (Liaison Committee) takes the position that the last sentence of § 209 (e)(1) has any application in proceedings under § 303(c)(1)(A) and (B) or 306 (c)(4)" since, if they did, the Court would desire to receive briefs and hear argument on the statutory and constitutional questions that would be raised. USRA has advised the Court that it does not take that position. Unless any party advances that position in its opening briefs, see p. [CA-5], the Court will consider that the taking of such a position with respect to proceedings under the cited sections is foreclosed.

(5) *Method of handling the valuation of property not owned by a primary debtor.* The discussions of valuation in the statements of the primary debtors and their security holders seem to assume, without detailed discussion, that the properties are first to be valued for each estate and that the total will then be distributed, in some way not clearly defined, as between the constituent transferors. This is an almost necessary consequence of the view, espoused by several primary debtors and their security holders, that the transferred property is to be valued as a going concern, and also conforms to what we understand to be the general practice in condemnation proceedings. The FSP, Vol. I, pp. 126, 145, shows separate values for each of the subsidiary debtors of Penn Central, and Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 gives a more detailed breakdown. The statements filed by the lessors seem to assume that they will receive the full value of their properties, without regard to the interest of the lessees; we have not been informed of the position of the latter. It may be that we have here a whole new set of issues which have thus far received relatively little thought.

The Court confesses it is somewhat baffled by the problem which bears, among other things, on the number and the duties of the masters to be appointed, and would welcome detailed proposals and briefing, even though it may be premature to attempt a definitive decision at this time. All parties desiring to express views on how this problem should be handled shall file briefs not later than August 23, 1976, answering briefs not later than September 21, 1976, and time requests for oral argument along with the answering briefs. The Court will then determine what further proceedings shall be had.

III. "Net Liquidation Value."

It is clear that, under § 306(c)(4), the Court is bound to determine the net liquidation value to which the transferors are

entitled by virtue of transfers of rail properties to ConRail under § 303(b)(1) as a step in determining the BV of the CV's, whether the value of the securities (including the CV's) issuable to the transferors is the same as or more or less than the Constitutional Minimum Value (CMV). The statements, however, reveal serious differences of opinion how this task should be performed.

A.

USRA's approach is summarized in FSP, Vol. I, pp. 124-26, and is stated in considerable detail in an Appendix, Vol. I, pp. 141-55. The essence of USRA's method is captured in the following paragraphs on p. 125:

> To resolve these and other issues, USRA postulated a "master liquidation plan" describing in detail an orderly process for the disposition of each estate's assets. The key assumption of the plan is that the estates would be required to sell substantial assets for continued rail use but that the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses. USRA assumed further that because of the valid requirements of common carrier regulations, the estates would operate under subsidies, if need be, and maintain their rail operations until 1979, at which time the orderly liquidation would begin. This subsidy period is also consistent with the self-interest of the estates in maintaining healthy price levels for their assets. USRA's plan also makes the favorable assumption that orderly cessation actually occurs and, therefore, prices are not adversely affected by the economic dislocations which would result if the actual service termination were abrupt and not orderly. The

> master liquidation plan also recognizes the physical requirement for preparing assets for sale and their effect on the timing of asset disposition.
>
> In essence, then, the liquidation plan postulated by USRA is for an orderly transfer of the transportation services provided by the estates to other railroads with the prices of such transfers computed as if the estates had actually been allowed to exercise their asserted right to liquidate by selling all of their assets for nonrail uses. The pricing under the assumption of total liquidation is based on supply and demand conditions which such a time-phased liquidation of rail assets into nonrail uses would produce. The pace of asset disposition is tied to the time required to accomplish a transition to alternate modes and to prepare assets for sale.

We have no doubt that this is one theory of determining net liquidation value that must be considered. However, as indicated in the March 9 letter, even if USRA's general theory were to be accepted, its calculations depend on a considerable number of assumptions which are open to contest.

We cite as examples, but without limitation, "[a]ssessments of the time and cost of preparing the assets for sale, and the expected time required to dispose of such assets once prepared for sale in light of supply and demand conditions" (p. 125); "[t]he overall economic environment within which these activities would occur" (p. 125); the method for arriving at the discount factors stated at p. 126; the details of the calculations as to when all necessary authority to sell rail properties would be obtained, pp. 145-46 (including the question whether, if certain transferors would have been obliged to shut down for lack of funds, any such authority would have had to be obtained); what was done in regard to properties that may be "rail properties" within the Act but are not in the sense that authority to sell would have to be obtained; and the assumptions with respect to the determination of the value of

rolling stock (pp. 146-48), facilities (pp. 148-49) and real estate (pp. 149-51).

In order to avoid wildly conflicting approaches by the masters appointed to deal with particular transferors, it seems essential that the Court, perhaps with the assistance of one or more Special Masters, should pass on the general validity of these assumptions, even though we recognize that any decision on this would simply establish something like a presumption which could be challenged by any transferor, e.g., by showing that it could have obtained authority to abandon at a date earlier than that hypothesized by USRA (or would not have required such authority because of lack of funds or for other reasons) or that it was a peculiarly favorable position to sell rail ties. The transferors insist that before anything can be done in the way of briefing, there must be extensive discovery of the details of USRA assumptions and the basis for them.

While we agree that some discovery is needed before there can be any effective briefing, we believe this should be in two stages. The first stage would be devoted to general questions such as those we have outlined. The second stage, which could go on while we were considering these general issues, would relate to more specific matters, e.g., the correctness of the count of rolling stock, track, etc., or the validity of the choices of other real estate sales selected to determine market value.

USRA has now taken an important first step by serving on the parties copies of its Master Liquidation Plan and of five valuation reports. While we do not anticipate that these will satisfy transferors even with respect to first stage discovery, this submission should suffice to enable them to formulate requests, which can then form the subject of consideration by the Acting Liaison Committee, substantially as proposed in the June 7, 1976 response of the Government parties, pp. 13-15. We direct the parties and the Acting Liaison Committee to proceed along these lines with respect to what we have characterized as first stage discovery of NLV methodology used by USRA and by any of the

transferors and the Acting Liaison Committee to report to us no later than August 23, 1976.

B.

We now turn to another and more basic matter. The chief quarrel on the part of the transferors and security holders with USRA's general approach to the determination of NLV, summarized in the paragraph quoted from FSP. Vol. I, p. 125, as distinguished from the subsidiary assumptions leading to the final figures, and also as distinguished from the question whether CMV is higher than the value of the securities issuable to the transferors, relates to the second sentence. Many of the statements claim that, at least for certain properties, the maximum liquidation price would be attained by selling them for railroad use.[11]

We do not understand that the statements of the Government parties altogether dispute this, see pp. 12-17 of the opening statement and pp. 9-12 of the responsive statement. After outlining a formidable series of hurdles that, in their view, a transferor would have to overcome before he could establish that sale to another railroad would yield more than sales for non-rail use, and urging that on this account, "the Court should presume that no hypothetical combination of dispositions would have produced a value higher than that attainable in a disposition of all of the transferred properties for nonrail use," they concede that "[t]his presumption could be overcome by a showing by a transferor that . . . it could and would legally and feasibly have disposed of some or all of its properties, for rail use, at a value determined other than by reference to the value attainable in a liquidation for nonrail use," (p. 17).

The Government parties argue that before any transferor can be allowed even to attempt this showing, there must be a preliminary proceeding in which, as we understand it, all transferors

seeking to make the attempt must develop a consistent "alternative scenario" and the Court is to pass upon its feasibility, considered as a whole. While the presentation of such a plan would greatly facilitate our consideration, the Government parties have not indicated how we could compel this. At the moment we are not persuaded that the procedure proposed by the Government parties is necessary or even feasible. The subject can be more intelligently considered when we know what transferors intend to show more advantageous dispositions for rail use and with respect to what properties.

Before we request transferors to advance their proposals, there seems to be a point of law the decision of which will importantly affect the proceedings. Several transferors appear to include in their claim that NLV should take account of higher prices obtainable for rail than non-rail use not only sales of certain properties to solvent railroads (or other private groups if any such were possible purchasers) but also sales of other properties to public bodies vested with the power of condemnation. At the moment we do not understand why in the absence of competing private purchasers, such public bodies could be expected to pay more than the NLV for nonrail use.[12] We think this question can be usefully briefed, argued and decided along with those enumerated in Part II, Items (1), (2) and (3). The question is this:

> Assuming that in determining "net liquidation value" as used in § 306(c)(4) the Court should take account of a higher price obtainable for certain properties on a sale for rail use rather than, as USRA proposed, "at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses" (FSP, Vol. I, p. 125), should the Court do this when the proposed sale is to a public body vested with the power of eminent domain, in

the absence of proof of a private purchaser ready and willing to make the purchase?

Once the Court answers this question, the next step would be to require the transferors to enumerate the possible transfers they desire to have considered. It may be that, as suggested by the PC Trustees (p. 23), the transferors will require the aid of discovery to assist them in doing this; the Government parties say that on this and other subjects discovery should be reciprocal. USRA could expedite matters if it would promptly make available to transferors any information which it has in regard to the interest (or lack of it) displayed by private parties in acquiring parts of the properties conveyed to ConRail, including the history of the aborted negotiations with the Chessie and the Southern; the transferors should similarly make available to the Government parties facts as to efforts made by them to effect such sales. The mechanics for this should be discussed in the Acting Liaison Committee and included in the report directed above. When the transferors have formulated their proposals, it may well be desirable to utilize the two-phase process suggested by the PC Trustees — a first phase in which the Court, perhaps aided by a Special Master, would determine the feasibility of the proposed transfers, and a second phase ascertaining the prices that would have been obtainable.

A number of the transferors have advanced theories for determining NLV that seem to have nothing to do with "liquidation," particularly in the light of the discussion at p. 199 of the Conference Report. As at present advised, we believe that the place for these theories is in the consideration of the constitutional minimum, which we will discuss in Part V of this Memorandum. The briefing and argument of the validity of these theories which is there directed can include the point raised in the two preceding sentences.

IV. Other Problems in Arriving at the Base Value of the Certificates of Value.

Since the discussion in Part III has taken us a considerable distance into the problems of § 306(c)(4), it will be convenient to complete our discussion of that section before returning to § 303(c)(1).

We think it would be desirable to separate the determination of BV into its three component parts, NLV, VOB, and CUE. We take it that Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 broadly reflects the position of the Government parties as to NLV. Any further revisions to take account of additional designations, property sales, and the changed conveyance date should be made promptly.

USRA has outlined its theories as to the determination of VOB in FSP, Vol. I, pp. 128-34. However, the FSP says that it had been "impossible within the statutory deadlines to arrive at any final quantification as to all categories of 'other benefits' "; that the figures given are at least in part "estimates and approximations"; and that USRA's "analysis will continue as regards both the quantification of established categories and the possible identification and quantification of additional categories." Most of the transferors claim that there are no, or few, "other benefits"; they also say that the failure of FSP to trace how the general principles stated on pp. 128-33 were translated into the figures in Tables 2 and 3 makes it impossible for them to voice their objections intelligently.

We think there is merit in the latter point, at least to the extent that the argument would be more meaningful if more details were known. We therefore direct USRA to prepare and file a more detailed explanation and calculation of VOB, taking such account as it thinks warranted of the criticisms in the statements. The objective would be to provide a statement in sufficient detail that we could rule on the issues of principle (i.e, whether a particular

category did or did not constitute a benefit) on the basis of USRA's statement and opposing affidavits going into principle rather than detail and thereby eliminate, as to categories we might rule out, the need for further discovery or factual presentation. USRA is directed to file such a statement not later than December 1, 1976. Again we urge USRA to be as forthcoming as feasible in its statement; the more that is voluntarily disclosed, within the realm of reason, the better are the chances for our being able to issue instructions to the masters without unnecessary advance discovery and taking of evidence. We also take note of the contention of some transferors that the benefits, in whole or in certain categories, are negative, and the legal problem arising therefrom. We believe that, at the appropriate time, this also can be handled by briefs supplemented with illustrative factual material — not in the sense of determining precise figures but in that of deciding whether the contention that "negative benefits" should be added rather than subtracted, or the more modest proposal that a "negative benefit" in one category is to be offset against positive benefits in others, are legally sustainable.

Turning to CUE, it now appears to us that there are three sets of legal issues which can be determined without awaiting the completion of detailed studies on the subject; indeed a relatively early resolution of these issues is essential in order to enable us to direct what studies should be prepared, since USRA contends that there has been no CUE.

Two of these issues concern the period of erosion claims. The statement of the Government parties takes the position, p. 28 n.19, that there can be no valid erosion claim for any period prior to enactment of the Rail Act — a position finding at least some support in our earlier opinion, 384 F. Supp. at 925. The transferors disagree. Secondly, some transferors take the position that there can be valid erosion claims for periods after the March 31, 1976 conveyance with respect to property not conveyed. The Government parties presumably disagree. The third concerns

the nature of the items qualifying as erosion claims. The statement of the PC Trustees (pp. 11-12) helpfully subdivides erosion into "financial erosion" and "physical erosion." The former would include the four items mentioned in our earlier opinion, 384 F. Supp. at 923, and possibly others of similar nature. Physical erosion is the deterioration of plant which may result in a lower NLV for the properties conveyed and lower realizable values for those not conveyed. We think the two issues of dates and the issue of the nature of the items qualifying for treatment as CUE can be resolved, or at least narrowed, as a matter of principle on the basis of factual submissions without the taking of detailed evidence since we would not anticipate serious conflict on the facts. We direct that all persons making claims of CUE shall file not later than October 13, 1976 detailed statements with supporting briefs which shall include the following:

(1) The date when they contend that valid erosion claims began. These should be supported by inclusion of petitions, reports and orders in the various reorganization courts and financial data that are claimed to be relevant.

(2) Any date later than March 31, 1976 to which they contend that erosion continued. The statements should give some idea of the nature and amount of any such post-conveyance erosion claims and shall present the legal theory contended to support them.

(3) The categories (and some approximation of the amounts) of erosion claims.

The Government parties shall answer not later than November 15, 1976, and the claimants may reply not later than December 7, 1976. The Court will then set a date for argument.[13]

V. Constitutional Minimum Value.

While, as mentioned in Part III of this Memorandum, Congress was of the opinion, Conference Report p. 199, that by providing for CV's it had assured the transferors of the constitutional minimum, that opinion is, of course, not conclusive. As also mentioned in Part III, we are presently of the view, while this is subject to change after brief and argument, that when Congress spoke of liquidation, it meant liquidation, although liquidation is not necessarily sale exclusively for nonrail use. Unless further briefing and argument should alter the view stated in the preceding sentence, we would consider, as previously indicated, that many of the contentions with respect to an expansive notion of NLV should rather be regarded as contentions that even an application of NLV taking full account of possible dispositions for rail use may not produce values equal to the constitutional minimum.

It would seem that if a railroad (or a segment which would have been allowed to operate pruned of unprofitable extensions) has capitalized earning power in excess of NLV, even in the "world" where most of the rail service provided by the bankrupt estates has ceased, the Constitution would require payment on that basis. If the Government parties contest this proposition, or desire to frame conditions about it which they believe we should impose as guidelines to the masters, they should include a discussion of this in their opening briefs.[14]

Apart from this the statements and answers can be said generally to reveal the clash manifested by the majority and dissenting opinions in *In the Matter of the Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734 (1967). Putting the matter in another way, they raise the issue whether and, if so, how far the Supreme Court would consider that the situations here presented require a departure from the standard that in condemnation "the question is what has the owner lost, not what has the taker gained," *Boston Chamber of Commerce* v. *City of Boston*, 217 U.S. 189, 195 (1910), and subsequent decisions. We see no

reason why we cannot formulate at least a general position on this subject without requiring the special masters to take detailed evidence on some or all of the many theories of valuation that would run afoul of the quoted standard if this is applicable. In saying this we do not mean to limit the parties to ordinary legal briefs. If any party believes it would be helpful to accompany its brief by affidavits or offers of proof, it may do so; the Court will consider these not as proof of the facts stated but for the light they shed on the legal issues. Such a course will meet the Supreme Court's comments in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 146 (1974), without requiring the vast expenditure of time and money that would follow from our leaving the issue of the constitutional minimum wholly at large until the masters have reported.

That issue, as we now see it, is whether the Constitution requires any valuation in excess of NLV properly defined, and as then used in § 306, plus any higher valuation of a railroad or segment derivable under the second paragraph of this Part V. Illustrative of the theories of valuation that would seem to fall if that question were to be answered in the negative are those propounded as theories of NLV in the statements of the Trustees of the Lehigh Valley, pp. 11, et seq.,[15] of the Erie Lackawanna, pp. 11, et seq.,[16] and of the Penn Central Trustees, pp. 9-11; those propounded as theories of the constitutional minimum in the statements of the Penn Central Lienholders, pp. 9, et seq.,[17] and the Committee of Secured Rail Creditors in the Penn Central Transportation Company Reorganization Proceedings;[18] the "true economic value" theory of the Penn Central Company; and the theory of the New Haven Trustee.[19] We emphasize that by mentioning the contentions of these parties as illustrations we are not relieving others who contend for a value higher than that formulated in the first sentence of this paragraph.[20]

There are three subsidiary issues that appear to require special briefing:

The first is this: Assuming that our answer to the question put above were to be generally in the negative, are there specific properties as to which valuation on the basis of NLV or a higher value based on capitalized earnings would be so manifestly unfair, because both factors work out at or near zero, that a higher value must be found and, if so, on what basis? This is essentially the question put by Judge Keating with respect to the Hudson River tunnel properties in *In the Matter of the Port Authority Trans-Hudson Corp., supra.* 20 N.Y.2d at 470, 231 N.E.2d at 739-40. While long tunnels of this sort are the paradigm, the transferors are invited to suggest other categories.

A second question, raised by the statement of the New Haven Trustee, is whether there is any requirement that the properties conveyed by the New Haven to PC should be valued on any higher basis than other properties.

A third issue, raised explicitly by the Lehigh Valley Trustee (pp. 23-24) but potentially of broad application, is whether the Constitution requires that compensation be given for any diminution in value of the assets severed and then left with the transferors, on a theory of inverse condemnation or otherwise. Here again, we would expect those propounding this point to give sufficient examples to enable the Court to understand the nature of the claimed diminution, not necessarily in dollar amounts but by categories.

We recognize the possibility that, after the briefing and argument here directed, we may decide that some of the issues propounded in this Part V are not ripe for decision, or may determine to afford the Special Masters greater leeway (possibly in the form of permitting requests for further instructions) than we now contemplate. Nothing will have been lost, however, since the issues set forth in this Part V will have to be briefed and argued at some time in any event, and the benefit attainable from our ruling in 1977 rather than many years later, after prodigious efforts before and by the special masters, which may be unnecessary, is so tremendous.

Recognizing that the issues raised in this Part V are of great consequence and that factual materials may need to be assembled, we shall allow considerably more time for the filing of papers. We set the following schedules:

Presentation of proponents - January 6, 1977
Presentation of Government parties - February 20, 1977
Replies of proponents - March 18, 1977

We shall defer fixing a date for argument until the papers have been filed.

VI. Petitions for leave to intervene.

In view of the large number of parties entitled to participate in these proceedings as a right, the Court cannot be as liberal in granting interventions as it might like to be. Indeed in some ways the intervention of creditor and stockholder interests may be counterproductive; insofar as they merely repeat arguments already ably made by transferors, they diminish the force of the latter. Paraphrasing Mr. Justice Stewart's well-known remark in *New York Times Co.* v. *United States*, 403 U.S. 713, 729 (1971), when everyone is heard, no one is heard. We are also mindful of the considerations concerning expense mentioned in Part I of this Memorandum. We are therefore granting intervention in these proceedings for the establishment of general principles to intervenors who have demonstrated a legal interest in the outcome and have taken or propose to take positions different from that taken by the transferors. What interventions shall be granted in proceedings relating to the application of the general principles to specific properties can be determined later.

Applying this criterion we grant intervention in the proceedings provided for in this Memorandum and Order to the following:

Institutional Investors Penn Central Group and certain Penn Central Indenture Trustees.

The First National Bank of Chicago as Trustee under First Mortgage Indenture of the Chicago River and Indiana Railroad Company, for the limited purpose of presenting arguments pertaining specifically to the C.R. & I.

Provident National Bank and A. Wakelee Swartz, Jr., as Indenture Trustees for Pennsylvania Tunnel and Terminal Railroad Company, and the Bank of New Jersey, as Indenture Trustee for New York Connecting Railroad Co., for the limited purpose of presenting arguments pertaining specifically to the named railroads.

Citibank, N.A., as Agent for the Committee of Secured Bank Creditors in the Penn Central Transportation Company Reorganization Proceedings, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the theory of valuation discussed in its petition and accompanying statement.

Richard Joyce Smith, Trustee of the Property of the New York, New Haven & Hartford R.R. Co., for the limited purpose of presenting contentions pertaining specifically to properties transferred by the New Haven estate to Penn Central.

Penn Central Company, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the issues outlined in its petition and accompanying statement.

The following applications are denied for lack of a sufficiently specific showing of inadequacy of representation by other parties in the proceedings provided for in this Memorandum and Order and, in some instances, for failure to file a statement of contentions as required by this Court's order of April 26, 1976:

Appendix A

Joint Application of Morgan Guaranty Trust Company of New York and eight other indenture trustees of Erie Lackawanna Railway Company Joint Application of Girard Trust Bank and four other indenture trustees of Lehigh Valley Railway Company.

Petition of John W. Sullivan, John D. Mabie, and Thomas A. Reynolds, Jr., minority stockholders of Reading Company.

Petition of Minority Stockholders of Mahoning Coal Railroad Co.

Petitions for leave to intervene have been filed on behalf of five governmental bodies listed in the margin.[21] As to almost all of the questions set forth in this memorandum, we fail to see that these bodies have an interest justifying even permissive intervention; the only exception would be if a contention were to be made that some of the transfers were not in the public interest, see Part II (1). These petitions are denied without prejudice to applications for limited intervention in the event indicated.

This constitutes an order; the parties shall proceed in accordance herewith.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge /

June 16, 1976

Appendix A

FOOTNOTES

1. The Court has adopted a new caption and docket number for general matters relating to the valuation proceedings under §§ 303(c) and 306. All papers subsequently filed in general proceedings dealing with valuation shall bear this caption and docket number. The Court will enter an order transferring from Docket Misc. No. 75-3 matters relating to these general valuation proceedings and also breaking Misc. No. 75-3 into various categories.

2. We use the term "securities" to include other forms of consideration moving to a transferor.

3. The problems would have been less under the bill as passed by the Senate which used the phrase "constitutional minimum" instead of NLV.

4. The valuation of the New Haven took four years even though there was general agreement that the property should be valued primarily on a scrap value basis.

5. Thus the statement on behalf of Reading Company and its wholly-owned subsidiaries says (p. 13):

> Therefore, the only proper instructions that this Court can give the Special Masters is to hear all evidence pertaining to value each party desires to introduce and to structure the appropriate theory of valuation at the end of the proceeding.

6. We use this term to include indenture trustees.

7. For present purposes, we include ConRail along with the United States and USRA in the term "Government parties."

8. It should be clearly understood that any expressions in this Memorandum and Order which relate to the merits or to procedures not herein prescribed are designed solely to assist in structuring these proceedings and do not indicate a prejudgment.

9. Here, as elsewhere in this Memorandum, we will take it for granted that parties who wish to establish that a question that has been raised has constitutional as well as statutory dimensions will develop the point in their briefs.

10. We use this phrase so as to exclude for present purposes the question whether to the extent that the statute is an eminent domain

statute, as the non-bankrupt transferors claim it necessarily is as to them, and as some other parties claim as well, the Constitution requires that the consideration be paid in cash.

11. This contention is to be distinguished from the argument that for certain segments the "highest and best use" would be retention by the transferor for railroad purposes. This sounds rather on the claim that CMV may exceed the value of the securities issuable to the transferors, although a determination of capitalized earnings would have evidentiary value for both.

12. Except, of course, in a situation similar to that envisioned in fn. 5.

13. The Trustee of the Ann Arbor has raised an issue of law peculiar to it. Since this estate has conveyed no property to ConRail, it will not obtain CV's. The Trustee wishes us to decide whether we have power to enter a deficiency judgment for CUE under § 303(c)(3) and direct payment by the United States under § 303(c)(5). If we should decide in the negative, the Trustee would like to proceed directly in the Court of Claims. We think it preferable to defer decision on this at least until we have passed on the general questions with respect to erosion outlined above.

14. In our 1974 opinion, 384 F.Supp. at 923 n.51, we took note of a theory which we thought to be then suggested by the Government parties, namely, that the constitutional minimum might be less than liquidation value in the case of a railroad (or perhaps a segment) with earnings which were sufficient that it could not obtain permission to abandon but whose capitalized value was less than liquidation value. The Government parties do not now seem to urge this except for making the point that if ConRail has sufficiently large earnings, there may be no need for determining net liquidation value. If the Government parties wish to preserve the contention averted to in the cited footnote, they should also include an argument on this in their opening briefs.

15. Real estate at fair market value plus an assemblage factor:

Improvements at the higher of a scrap value or going concern value:

Going concern value measured by a combination of:

Capitalized prospective earnings

Public usefulness (the price of reconstruction or of a substitute facility)

RCNLD in appropriate instances

Value in place (i.e., scrap value with no subtraction for dismantling).

16. Capitalized earning power as basis for sale to another railroad:

Gross liquidation value (i.e., no cost for dismantling) as basis for sale to another railroad;

"Special Value" to a public body (e.g., a state) calculated by some combination of:

Depreciated value of track

Market value of land, plus assemblage factor

Gross liquidation value

Value of a developed operating organization

Value of not having to develop more costly alternatives

RCNLD of special facilities;

"Residual Value"—i.e., value as an integrated network.

17. Value properties as an assembled unit (i.e., apparently as a "going concern") by an appropriate combination of:

Land at fair market value plus assemblage;

Track at depreciated value;

Related facilities at cost plus appreciation;

Intangibles at cost of production less obsolescence;

For special facilities, RCNLD;

Value to public in terms of costs of alternatives.

18. "[W]hat it would have cost an acquiring entity on April 1, 1976 to buy, in an arm's length transaction, the conveyed real estate and to then build an integrated rail system . . . on that real estate . . . (p. 4)"

Appendix A

19. Presumption of reconstruction cost new less depreciation unless the Government parties rebut this.

20. We have not mentioned the contentions of the Government parties as to "ConRail use value" since we do not understand their precise relevance. If the Government parties wish these to be considered as part of the proceedings here contemplated, they should make a further submission on the subject not later than August 15, 1976.

21. The Commonwealth of Pennsylvania, the State of Delaware, the Department of Transportation of the State of New York, the Maryland Department of Transportation and the city of Philadelphia.

Appendix A

Schedule

Subject

(1) "Public interest"; "fair and equitable"; reorganization vs. eminent domain statutes, reckless or deliberate disregard clause, § 209(a)(1)—see Part II, Items (1), (2), (3) and (4); relevance of possibility of sale for rail use to public bodies having power of condemnation, see Part III.

Opening briefs—August 23
Answering briefs—September 21

(2) Method of handling the valuation of properties not owned by primary debtors, see Part II, Item (3).

Opening briefs—August 23
Answering briefs—September 21

(3) Report by Acting Liaison Committee with respect to first stage discovery on NLV methodology and on efforts by USRA and transferors to effect sales for rail use to private parties.

August 23

(4) Date on which USRA shall file detailed statement of value of other benefits.

December 1

(5) Filing by transferors of statements and briefs with respect to uncompensated unconstitutional erosion: October 13

Response by Government parties: November 15
Replies: December 7

(6) Briefs (accompanied by affidavits or offers of proof) on constitutional minimum.

Opening briefs—January 6
Answering briefs—February 20
Reply briefs—March 18

APPENDIX B

Appendix B

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Special Court—Misc. No. 76-1

Filed October 18, 1976, James F. Davey, Clerk

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

Opinion with Respect to Issues Set for Briefing and Argument as Subjects (1) and (2) of Schedule Attached to Memorandum and Order of June 16, 1976

FRIENDLY, Presiding Judge:

In our Memorandum and Order of June 16, 1976 (hereafter "June 16 Memorandum"), a copy of which is appended to this opinion as an addendum, issued after we had received statements of position from the parties and answers thereto, we sought to identify certain issues of principle early determination of which by this Court would enable us to frame appropriate instructions to the special masters who will take detailed evidence. Opening briefs on various subjects were due by August 23, with answering briefs to be filed on September 21. Oral argument was heard on September 27. In this opinion we deal with most of these subjects, although, as anticipated in the June 16 Memorandum, we find that an attempt at resolution of some would be premature.

Appendix B

I. "PUBLIC INTEREST"

Section 303(c)(1)(A) of the Rail Act directs that after the transfers and conveyances of the properties designated in the FSP, this Court "giving due consideration to the findings contained in the final system plan" shall determine, among other things, whether such transfers or conveyances "are in the public interest". We raised the question what our responsibilities in making that determination could be since a number of provisions of the Act and materials in the legislative history indicated that we were not to pass generally on the merits of the FSP from a transportation standpoint,[1] a task performed initially by USRA and later in some degree by Congress itself, and also because any large scale reconveyance would be impracticable.

Most of the parties, evidently sharing our inability to discern what Congress expected of us, have advanced no suggestions on this. The E-L Trustees suggest that the "public interest" clause might require us to consider the viability of ConRail at the time when it becomes necessary to distribute the Series B Preferred Stock and the common stock, whose fair market value is deductible from the base value of the certificates of value, § 306(c).[2] We are not greatly impressed by the argument but we need not deal with it at this time since the date of the distribution unhappily is far in the future.

The Trustees of the Reading suggest that the "public interest" requirement compels us to pass on contentions that the designations of certain property do not meet that criterion. They cite as examples the designation of Reading's 3,000 shares (all the capital stock) of the Washington & Franklin Railway Company, which is leased to the Western Maryland Railroad Company, a Chessie System subsidiary, under a 995-year lease running from July 1, 1901, and Reading's 500 shares of stock in the Trailer Train Company. The First National Bank of Chicago, as Trustee under the First Mortgage Indenture of The Chicago River and Indiana Railroad Company, raises a somewhat similar question

with respect to the Ashland Avenue year in Chicago.[3] Finally, the North Pennsylvania Railroad Company, the Delaware and Bound Brook Railroad Company, the Philadelphia, Germantown and Norristown Railroad Company, and the Plymouth Railroad Company, question whether two properties—one belonging to the Bound Brook and allegedly without rail use, and the other consisting of various overhead utility wire rental agreements—were properly designated.

Although we are cognizant of the arguments, based particularly on the final sentence of § 208(d)(2), on § 208(d)(3)(C), and on the final sentence of § 209(e)(1), that may be made against such review, we are not disposed to rule out the latter without further briefing. Contentions that particular transfers were not "in the public interest" raise some of the same questions as contentions, raised at an earlier stage of the proceedings before us, that certain designations were not of "rail properties" as defined in § 102(12). It is highly desirable that if any transfers or conveyances are to be annulled as not in the public interest or as unauthorized, this should be determined before time and effort are expended in valuing them. We therefore direct that any claims that transfers or conveyances were not in the public interest or were unauthorized be filed, in the form of complaints in separately numbered actions, not later than December 1, 1976, and order that any claims not so filed will be deemed to have been waived. Notice of this direction will be promptly mailed by the Court's executive attorney to counsel for all transferors who appeared in the transfer proceedings, Misc. No. 75-3. We, of course, encourage the parties to endeavor promptly to settle any disputes of this sort; an appendix to the answering brief of the Government parties indicates that such efforts are in progress with respect to several of the properties we have mentioned.

Save to the extent here indicated, we shall instruct the special masters not to give further consideration to the "public interest" criterion of § 303(c)(1)(A) insofar as it relates to setting a

standard of valuation unless a party makes a specific and supported request to that end, showing that a different result would ensue from application of the criterion, in which event the master shall seek this Court's further instructions.

II. "Fair and Equitable"

Section 303(c)(1)(A) also requires us to make a finding, subsequent to the transfers and conveyances, that these

> are fair and equitable to the estate of each railroad in reorganization in accordance with the standard of fairness and equity applicable to the approval of a plan of reorganization or a step in such a plan under section 77 of the Bankruptcy Act (11 U.S.C. 205), or fair and equitable to a railroad that is not itself in reorganization but which is leased, operated, or controlled by a railroad in reorganization. . . .

In the June 16 Memorandum we expressed doubt whether these words, generally used in corporate reorganization law to deal with the distribution of the securities of a reorganized company among various classes of creditors and stockholders, had any practical application to the valuation of the properties "in view of the facts (a) that if the consideration is 'fairer and more equitable than is required as a constitutional minimum,' § 303(c)(3) requires us to eliminate the excess, and (b) that if the consideration were less than the constitutional minimum, it would not be fair and equitable."

Here again most of the parties share our inability to discern why, under the terms of the Rail Act, the requirement that we find that the consideration is more than, less than, or equal to the "constitutional minimum" does not drain the "fair and equitable" language of all meaning as regards the adequacy of the total consideration to be received by each transferor.[4] Accordingly we propose to instruct the special masters that in valuating the

properties they need not address themselves to the fair and equitable standard as distinguished from the constitutional minimum in the absence of a specific and supported claim that a different result would ensue from application of such a standard, in which event the master shall seek this Court's further instructions.

III. Reorganization vs. eminent domain statute

In the June 16 Memorandum we requested the parties to brief the question "whether the standard of valuation should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both." (P. 9, footnote omitted). The question how far the Rail Act is a "reorganization statute" and how far it is an exercise of eminent domain was considered by this Court in *In the Matter of Penn Central Transportation Company*, 384 F. Supp. 895, 926-38, 948-52 (1974) (sometimes hereafter "our 1974 decision"), and, more importantly, by the Supreme Court in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 148-55 (1974).

In light of the briefs and argument, we now have some doubt whether the question we put in our June 16 Memorandum was precisely the right one. Perhaps the question could be more accurately stated as being whether the Act involves a taking and, if so, whether the "constitutional minimum" required both by the terms of the Act and by the Fifth Amendment differs if the Act should be regarded as a reorganization statute enacted under the bankruptcy power or as a statute enacted under the commerce power or as both.

The transferors and creditor and stockholder interests argue that the Rail Act is a taking within such cases as *United States* v. *Causby*, 328 U.S. 256 (1946), and *Armstrong* v. *United States*, 364 U.S. 40 (1960), and that the constitutional minimum must, therefore, be a figure established in light of the body of case law relating to eminent domain, of which they regard the decision in *In the Matter of the Port Authority Trans-hudson Corp.*, 20

N.Y.2d 457, 231 N.E.2d 734 (1967), *cert. denied*, 390 U.S. 1002 (1968), as a significant example. They would dispose of the Supreme Court's indication, 419 U.S. at 155, that the only taking is of the "shortfall" between the constitutional minimum and the value of the compensation provided under the Act on the basis that this formulation requires judicial determination of what constitutes a constitutional minimum and that the process of determining the amount of any "shortfall" thus is no different than if the entire property were taken. In other words, they regard the Count's emphasis on the Act's being a valid exercise of the bankruptcy power and thus a reorganization statute, 419 U.S. at 153, as being a basis for upholding the validity of the Act without the Court's being obliged to decide whether compensation other than money may be adequate under what is solely a condemnation statute, see 419 U.S. at 149-55, rather than as implying that the constitutional minimum would be different than if the Rail Act had been enacted solely under the commerce power.

The Government parties point to other arguments which look the other way. They cite this court's statement, 384 F. Supp. at 927, that Congress did not have to choose between "the Scylla of outright condemnation and subsequent nationalization and the Charybdis of a collapse of rail transportation in the most heavily industrialized section of the country"; they argue from this that we did not believe that the Rail Act constituted "outright condemnation." They refer also to the Supreme Court's statement, 419 U.S. at 152-53, where in answer to a contention that the Rail Act's provisions "for a compelled conveyance and for the continuation of rail services pending formulation of the Final System Plan constitute the Act a condemnation statute", the Court found "no significance in these features of the Act" since "Congress, in enacting those provisions, clearly intended to legislate pursuant to the bankruptcy power", and followed this up with a reference to *RFC* v. *Denver & R.G.W.R. Co.*, 328 U.S. 495 (1946), "where the Court sustained the 'cram down' provision of § 77 authorizing a reorganization court to confirm a plan despite its rejection by

creditors." Stressing the creditors' and stockholders' continued ownership in the assets conveyed to ConRail by virtue of the distribution of the Series B Preferred and common stock to the transferors, the Government parties argue that if Congress had simply authorized or directed a reorganization court to carve out the most productive elements of a bankrupt railroad and transfer them to a new corporation in exchange for its securities, this would have come within traditional reorganization concepts and that no different result is required because the Rail Act dealt with the assets of a number of primary and secondary bankrupts and even of non-bankrupts whose properties were leased or controlled by bankrupts. See in this connection the discussion at 384 F. Supp. at 951-52. The upshot of the contention of the Government parties is that the constitutional minimum for the properties transferred should be determined solely by reference to the value of realistic choices of which the Rail Act deprived the transferors, rather than under principles of condemnation law if the latter should in fact be different, which they deny.

In light of our conclusion that determination both of net liquidation value and of the constitutional minimum requires consideration of evidence showing significant likelihood of sales for rail use, it is difficult at this point to appraise exactly how much may ride upon the difference between these views. It is clear, however, that the amount may be substantial. In the light of the extensive and helpful briefing and argument, it now appears to us that a decision as between the respective positions at this time might significantly impinge upon our determination of constitutional minimum value discussed in Part V of our June 16 Memorandum which we set for more detailed briefing in early 1977. Accordingly, we conclude that it is not desirable at this time to answer the question put in Part II(3) of our June 16 Memorandum, as put or as here recast, and that we should defer decision until we have received the briefs therein specified and heard further argument.

Appendix B

IV. Sales to public bodies for rail use—and herein of "net liquidation value."

On p. 16 of the June 16 Memorandum we posed the following question:

> Assuming that in determining "net liquidation value" as used in § 306(c)(4) the Court should take account of a higher price obtainable for certain properties on a sale for rail use rather than, as USRA proposed, "at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses" (FSP, Vol. I, p. 125), should the Court do this when the proposed sale is to a public body vested with the power of eminent domain, in the absence of proof of a private purchaser ready and willing to make the purchase?

For the reasons indicated below, the submissions convince us that the transferors should be left free to develop the significant likelihood of such sales and the prices expectable therefrom, following the procedures outlined on pages 16 and 17 of our June 16 Memorandum.

The Government parties argue strenuously for a negative answer to the question posed. They rely heavily on the point that sale to a public body even for rail use would constitute an abandonment requiring a certificate from the Interstate Commerce Commission under § 1(18) of the Interstate Commerce Act; that § 1(20) authorizes the Commission to "attach to the issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require"; and that the Commission frequently includes as a condition a "salvage value clause." This typically reads:

> [T]he applicant [shall] sell the branch or any part thereof, to any person or persons offering . . . to purchase

> the same for continued operation at a price not less than the net salvage value thereof.

Texas & N.O. R.R. Abandonment, 282 I.C.C 1, 13 (1951). See also *Jamestown, W. & N. R.R. Abandonment*, 217 I.C.C. 739, 740 (1937); more recent cases cited in *New haven Inclusion Cases*, 399 U.S. 332, 472 n.74 (1970); C. Cherington, The Regulation of Railroad Abandonments 172 n.42 (1948). The Government argues that, having fair assurance that the Commission would include such a clause, no rational purchaser, public or otherwise, would pay more than salvage value unless required to do so by the threat of a higher competitive bid.

Although we do not preclude the Government parties from further argument on this point, we are not much persuaded. The purpose of such clauses is, as stated *in Tennessee Central Ry. Abandonment*, 333 I.C.C. 443, 455 (1968), to insure that an applicant for abandonment "give first consideration to any offer for acquisition which contemplates continued operations over all or substantially all of its line railroad." The Commission's specification of salvage value has occurred in contexts in which the owner was proposing to scrap the branch and had no better alternative in view. It is the continued operation, not preventing an owner from securing an optimum price, which is the Commission's prime objective. As the Commission stated in *Washington and Old Dominion Railroad Abandonment*, 331 I.C.C. 587,599-600 (1968), review action dismissed without need to discuss the point, *Washington and Old Dominion Users Ass'n v. United States*, 287 F. Supp. 528 (E.D. Va. 1968),

> Ordinarily the prescription of a price in the terms "not less than net salvage value" sets only the bidding minimum and guarantees that the abandoning railroad will not have to take less in a sale of the line intact for future operations than it could obtain by disposal otherwise. What price is

> actually paid depends, in most instances, upon circumstances, peculiar to each case—though not less than net salvage value. It might be the highest price bid above scrap value; or a price stated by the carrier as satisfactory to it; or some amount above a stated salvage value; or a price negotiated at arms length by the abandoning line and the acquirer.

Although this was said in a case where the proposed disposition at a figure higher than salvage value was for highway rather than railroad use, the Commission has also refused to use the salvage clause as a means for limiting the amount which a railroad seller may obtain from a railroad purchaser. *Chicago, M., St.P. & P. R.R. Abandonment*, 347 I.C.C 1, 2 (1973). The Commission there said it was of the view:

> that in prior proceedings involving conditions such as that herein, the Commission has not undertaken to set the *maximum* price for the sale of such trackage [see, *Washington & Old Dominion R. Abandonment—Virginia*, 331 I.C.C. 587, 599 (1968)]; that it has been recognized, among other things, that to do so would be an unwarranted interference with the contractual rights of the parties; that setting a maximum price based solely on the net salvage value of the line might ignore other factors, such as the value of the right-of-way, having a reasonable bearing on a fair price for requiring continued operations of the line in the interest of the public; that in establishing the standard of net salvage value as a *minimum*, reasonable price, the Commission has been cognizant that a railroad should be able to recover at least this much of its capital investment in its line in exchange of foregoing the opportunity of selling the trackage for other than transportation purposes or for possible usage of the trackage in other parts of its system. . . .

The Government parties have pointed us to no case where the Commission insisted on sale at salvage value where a purchaser for continued use, even in the absence of competition, was willing to pay more, and we are by no means certain that the Commission lawfully could attach a salvage clause in such a situation, even if, as apparently is not the case, its policy were to do so. Insofar as a statement in *New York, N.H. & H. R.R. Bondholders' Committee* v. *United States*, 289 F. Supp. 418, 435 (S.D.N.Y. 1968), may indicate that the Commission could and would require a sale at salvage value where a public body would be compelled to pay more under a state condemnation statute, this was said in a case where there was no proof of interest by the public body in a consensual sale at a price above salvage value and without the court's having had the benefit of citation to the Commission decisions in the *Old Dominion* and *Milwaukee* cases, the latter of which had not yet been rendered.

Furthermore, it is not certain that all abandonments will have to await action by the Commission. In this Court's 1974 opinion, 384 F. Supp. at 919 n.31, we stated our assumption that abandonment procedures might have to be pretermitted if a reorganization trustee ran out of cash after exhausting all reasonable efforts to raise it. The answering brief of the CNJ Trustee (p. 11 n. 9) considers this to be only one instance of a general principle that a certificate of abandonment is not required when cessation of operations is compelled by circumstances beyond the railroad's control. See also reply brief of Penn Central Lienholders, p. 26. Since this question is also important on the issue of the timing of sales for scrap, we prefer not now to decide how far our assumption or the broader argument noted is sound; it suffices that the points are sufficiently arguable that we would not wish to decide them against the transferors at this time.

Finally, transferors and creditor interests have cited examples in which public bodies vested with the power of eminent domain have paid more than scrap value for railroad properties desired for continued use even in the absence of competition and have

given reasons why this behavior would not be irrational even if the arguments of the Government parties with respect to salvage clauses were sounder than we now think them to be. Among these are the desire for a speedy settlement to prevent further decreases or deterioration of service; the possibility that a certificate of abandonment might not be required; the desire to acquire not simply physical assets but an operating organization; fear that a reorganization court might not approve a sale at salvage value; and the fact that state condemnation statutes might require payment of more than scrap value so that a settlement may be cheaper as well as swifter than condemnation proceedings. For all these reasons we think that transferors and creditors should be free to develop realistic possibilities of sales of particular lies to public bodies at higher than scrap value even in the absence of proof of competition; the Government parties will, of course, be free to counter any such proof with any relevant evidence.[5] The Court calls attention to the procedure for handling the subject of sales for railroad use generally which is outlined on pages 16 and 17 of the June 16 Memorandum and urges that this process be expedited.

V. NET LIQUIDATION VALUE VERSUS CONSTITUTIONAL MINIMUM

On p. 17 of the June 16 Memorandum we stated:

> A number of the transferors have advanced theories for determining NLV that seem to have nothing to do with "liquidation," particularly in the light of the discussion at p. 199 of the Conference Report. As at present advised, we believe that the place for these theories is in the consideration of the constitutional minimum, which we will discuss in Part V of this Memorandum. The briefing and argument of the validity of these theories which is there directed can include the point raised in the two preceding sentences.

Despite this, the brief of the New Haven Trustee[6] contains an extensive argument that NLV should be read as the equivalent of CMV. Although we shall abide by our commitment not to decide this issue until the briefing and argument of subject (6), we think that since the issue has been ventilated, it would assist the parties if we stated why, whatever the desiderata might be, we are unconvinced at the moment that a determination of net liquidation value embraces all the elements that may be called for in determining the constitutional minimum.

The Rail Act as adopted on January 2, 1974, 87 Stat. 985, did not require a determination of net liquidation value. Neither did the Senate version of the 1976 Act, S. 2718, 94th Cong., 1st Sess. The provision in the Senate bill for determining the base value of the certificates of value was that this "shall be the value obtained by taking the constitutional minimum value, if any (as determined pursuant to section 303(c)(1) of this title)," plus and minus certain items.

In passing the bill in this form the Senate overrode an objection from the Secretary of Transportation reading as follows:

> The base value of certificates of value should not be established at whatever figure the Special Court designates as the constitutional minimum. Such a provision will seem to signal a congressional repudiation of both USRA's net liquidation value theory and Congress' own intention in the Regional Rail Act to provide for a reorganization, not a condemnation, of the bankrupt railroads.

S. Rep. No. 499, 94th Cong., 1st Sess. 315-16 (1975). The House Committee, however, substituted the words "the net liquidation value, as determined by the special court" for the Senate's "constitutional minimum." H.R. 10979. The Report of the House Committee on Interstate and Foreign Commerce, H.R. Rep. No. 725, 94th Cong., 1st Sess. 121 (1975), accurately described the House version but did not explain the reason for the

change from the Senate's. It did contain a letter from the Secretary of Transportation commending "the improvements the Committee made to the provisions on certificates of value" and indicating that if these were to be changed on the floor, "the bill would not be acceptable to the Administration". *Id.* at 282. Faced with this, the Conference Committee adopted the House version, with no explanation other than that

> The role of the certificates of value is to assure that these private interests will fare no worse than under the liquidation alternative.

H.R. Rep. No. 781, 94th Cong., 2d Sess. 199 (1976).

We may agree with the New Haven Trustee that it is hard to see how the change demanded by the Secretary of Transportation benefits the Government in the long run. If the certificates of value, determined on the basis of net liquidation value, plus and minus the other elements requiring consideration, are less than the constitutional minimum, a figure which this Court, subject to review by the Supreme Court, was necessarily left free to determine, the balance would be awarded—not indeed by action of this Court but as a result of further expensive and time-consuming proceedings in the Court of Claims. But quite obviously the Secretary thought he might be accomplishing a change in the standard for determining the base value of the certificates of value, and left Congress no feasible alternative save to go along. This history itself seems to preclude our reading the two terms to mean the same thing, even though the differences may not be so great as the Secretary thought. The term "liquidation" normally implies a sale, although not necessarily a sale for scrap value; the constitutional minimum may well be more—a point we reserve for decision after further briefing.[7] If this analysis is in error, the parties should clearly point out why.

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VI. PROCEDURE FOR VALUATION OF PROPERTY OF SECONDARY DEBTORS AND NON-BANKRUPT TRANSFERORS.

There appears to be general agreement that, whatever this Court's ultimate responsibilities may be, the proceedings before the special masters should not concern themselves with the respective interests of lessor and lessee in an award for the same property. We endorse that conclusion and think it is premature to consider how that issue should ultimately be handled.

With a few exceptions the parties seem also to agree that since it will be desirable (although not necessarily sufficient) to value the system of each primary debtor as a whole and since it may be that many elements of VOB (value of other benefits) and CUE (compensable unconstitutional erosion) can be determined only on a system-wide basis, we should appoint special masters with reference to the estates of the primary debtors (doubtless several in the case of the Penn Central) rather than designate separate special masters for each transferor (or group of transferors). We agree with that position. The contrary argument of a few rather small transferors, based largely on the supposed speed with which their problems could be solved, ignores the interdependence of all transferors created by § 303(c)(2) and the undesirability that initial determination by this Court and review by the Supreme Court should take place in what may be a wholly atypical case.

However, there is a difference of opinion whether each special master should content himself with a finding with respect to the system or conduct the hearing so as to enable him to make additional findings with respect to each transferor.

There would seem to be no doubt that under §§ 303(c)(1)(A) and 306(c)(4) findings as to each transferor will ultimately be required. The question therefore is one of relative convenience—will it be simpler and fairer to have the special masters arrive at figures for each system, which presumably we will review, and then start over again with respect to each transferor

within the system, or to conduct the hearings in the estate of each primary debtor with a view to making the separate findings concerning various transferors that will ultimately be needed. We think the latter.[8] Certainly a transferor must be permitted at some time to present a theory (within the parameters established by this Court) resulting in a higher valuation for its property than would result from allocation of a system value; we would think this could better be done in the same proceeding in which the primary debtor is presenting its theory, particularly since a higher value for the property of one transferor might reduce the value of the properties of others. Generally time will be saved if the parties address themselves to the question of relative shares at a date when the necessary figures are more likely to be available rather than postpone the problem to a distant future when records and knowledgeable witnesses may have disappeared. On the other hand, we shall expect the various transferors to live up to their promises of cooperation with the primary debtors and the masters in an effort to minimize time and expense.

Finally, referring to Part II(4) of the June 16 Memorandum, we note that no party has taken the position that the last sentence of § 209(e)(1)—the "reckless or deliberate disregard" clause—applies to valuation proceedings under §§ 303(c)(1)(A) and (B) or 306(c)(4). Accordingly the Court will consider the taking of any such position to be foreclosed.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

.....

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge

October 18, 1976

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FOOTNOTES

1. *See* Regional Rail Reorganization Act of 1973, *as amended*, § 209(a) second sentence; Report of the Committee of Conference of S. 2718, H.R. Rep. No. 781, 94th Cong., 2d Sess. 187-88 (1976).

2. A similar suggestion is made by the Trustee of the Central Railroad Company of New Jersey, and by the Intervening Penn Central Lienholders. *Cf.* opening brief of the Trustee of the Lehigh Valley Railroad Company; brief of the Trustee of the Lehigh and Hudson River Railway Company.

3. The FSP, Vol. I, p. 262, limited the designation to the portion of the yard "needed to sustain ConRail operations." The Bank contends that the portion ordered to be conveyed was in excess of this.

4. As noted in the June 16 Memorandum (p. 8), the Government parties suggest that fairness and equity might entitle transferors of particularly strategic properties to larger allocations of ConRail Series B Preferred and common stock, which would give them a larger share in the envisioned future prosperity of ConRail. This issue is a long way off and we need not consider it now.

5. The Government will doubtless claim that a state would not be interested in making the substantial payments required for taking over main line (as distinguished from commuting) operations without assurance that other states would take similar action to the extent required to constitute a viable system. The transferors thus might be well advised in their own interests to develop an "alternative scenario" (or a number of such scenarios) of the sort discussed in the statement of contentions of the Government parties (see June 16 Memorandum p. 15).

6. This brief disregards the limitation imposed by us on granting intervention to the New Haven Trustee, namely, that this was "for the limited purpose of presenting contentions pertaining specifically to properties transferred by the New Haven estate to Penn Central." June 16 Memorandum p. 26. Our object in allowing intervention by the New Haven Trustee was to permit him to present contentions arising out of the inclusion of the New Haven in the Penn Central, such as, to take one example, a claim that the New Haven's properties having once been valued should not be revalued except to take account of subsequent dispositions and the fact that certain properties were not transferred to

ConRail. It was not and is not our intention to allow the New Haven Trustee to intervene to present positions with respect to valuation issues where the New Haven's interest as a creditor of Penn Central is adequately represented by the Penn Central Trustees.

7. The strongest case would be where a piece of railroad which the Interstate Commerce Commission would allow to be operated shorn of unprofitable track would earn an income whose capitalized value would exceed net liquidation value.

8. There are some instances in which a line is leased or controlled by more than one primary debtor; in these cases the parties have reached or are in the course of reaching agreement as to the estate in which the valuation is to occur.

Appendix B

Addendum

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT[1]

MEMORANDUM AND ORDER DIRECTING PRELIMINARY PROCEEDINGS FOR THE DETERMINATION OF GENERAL PRINCIPLES UNDER §§ 303 AND 306 OF THE ACT

I. HISTORICAL BACKGROUND AND GENERAL CONSIDERATIONS.

In this Court's opinion of September 30, 1974, 384 F. Supp. 895 at 926 n.53, we said that, as we then envisioned, our initial task after the conveyances provided in § 303 of the Act, "would be, after suitable briefing and argument, to set the principles for valuing the properties conveyed." These principles would then be applied to specific properties by a number of special masters, whose decisions we would review. It would have been premature to attempt to analyze just what issues would benefit from such advance determination, and we likewise did not address ourselves to such questions as whether an initial setting of guidelines would require discovery or the taking of evidence.

The extensive amendments made in Title VI of the Railroad Revitalization and Regulatory Reform Act of 1976 have considerably augmented the difficulties of what already was probably the most gigantic task ever confided to a court. The added problems arise in considerably part from the Amendments' creation of a new form of security which is to comprise a part of the

consideration payable to railroads that have transferred property to ConRail, namely, "certificates of value" (CV's), § 306, which are to be redeemed by USRA not later than December 31, 1987, § 306(c)(1); the CV's are guaranteed by the Secretary of Transportation, constitute general obligations of the United States, and carry of pledge of its full faith and credit, § 306(a). A separate series of CV's is to be issued to each transferor, § 306(b). Critical to ascertainment of the redemption price is our determination, § 306(c)(4), of the "base value" (BV) of each series. This is computed by determining the "net liquidation value" (NLV), to which the transferor may be entitled by virtue of transfer of property to ConRail, subtracting the value of other benefits provided under the Act (VOB), adding compensable unconstitutional erosion (CUE), and finally adding interest compounded annually at the rate of 8% per annum; to get the BV of each certificate, the figure just obtained is divided by the number of certificates in the series. The formula, omitting the interest item and the final division, thus is:

$$BV = NLV - VOB + CUE$$

A principal problem is that this new concept was superimposed on the concepts of "public interest," "fair and equitable," and "constitutional minimum" in § 303(c) without any clear indication in the statute itself, as distinguished from the legislative history, what Congress considered was the relationship of the securities issuable to the transferors[2] as prescribed by § 306 and the standards laid down in § 303.[3]

The added complexities created by the 1976 Amendments seemed to us to heighten the necessity for this Court to make as many determinations of law as possible, at least in a preliminary fashion, before putting the special masters to work. Putting aside for the moment the secondary debtors of Penn Central (PC) and the non-bankrupt lessors, we have seven primary debtors, and it is apparent that more than one special master will be required in the case of Penn Central (PC) and perhaps in that of

the Erie-Lackawanna (EL) if undue delay is to be avoided;[4] realistically therefore when we speak of special masters, we are thinking in terms of at least ten.

Because of such considerations the Court, on March 9, 1976, sent a letter to all members of the Acting Liaison Committee which the Court had appointed, outlining the Court's tentative views of what legal issues required decision and raising a number of procedural questions. This led in turn to the Court's order of April 26, 1976, prescribing a procedure whereby all parties were invited to file statements commenting on the issues and the structure of this proceeding, with an opportunity to file answers responding to the statements of others. The order also set forth a procedure whereby persons not named as parties might apply for leave to intervene. The Court has now reviewed these statements and answers, many of which have been exceedingly helpful.

While substantially all the comments recognize the existence of some questions which the Court may now determine after appropriate briefing and argument, most take a rather parsimonious view on this score. Although professing to recognize the necessity of providing the special masters with guidelines, many of the proposals seem to be that the special masters shall take evidence on whatever theory passing the lowest threshold of rationality may be offered to them.[5]

We think this would produce utter chaos. If a transferor or security holder[6] is allowed to offer evidence based on a certain theory of value, the Government parties[7] could not afford simply to argue that the theory was wrong; they would be obliged to cross-examine and offer rebuttal on the detailed application of the theory since for aught that would appear we might adopt it. Similarly the special masters would be obliged to make factual findings with respect to all theories even though we were to relieve them of the task (which we would reserve for ourselves) of choosing among them.

While we respect the zeal displayed by the parties, there are other considerations that must be borne in mind. The PC has

already been in reorganization for six years, the CNJ still longer, and the New Haven since 1961. It has now become apparent that a good many months will elapse before the special masters can profitably be put to work in any event. It is impossible to predict how long their labors will take under the best of circumstances, and if we had not already determined the proper principles we would be at the mercy of the slowest, since otherwise our determination in the earlier cases would govern the later ones without having afforded the parties in such cases a hearing. After the masters' reports will come our own consideration and decision on a mammoth record, and appeal to the Supreme Court, and possibly proceedings in the Court of Claims. Until all these steps, save perhaps the last, have been completed, the reorganization courts will be unable to make meaningful progress with their individual plans and the expensive administration of these estates, some of which are understood to be on the verge of actual insolvency, must continue. Indeed we have considerable doubt whether, under the procedures proposed by some parties, the CV's could be valued by December 31, 1987, their redemption date. The legal and other expenses of the litigation in this Court will be tremendous in any event and would become even more staggering and a legitimate subject for public concern if the litigation were protracted beyond the necessities of the case. Given all this and the fact that no procedure can produce a mathematically perfect result, it behooves all concerned with this proceeding to cooperate in devising procedures that will shorten the interval before final decision to the the full extent compatible with essential fairness. We believe it is possible to devise procedures that will enable us to decide a large number of basic questions before the special masters go to work, although there are other matters on which there is no need for an early decision. In saying this we are conscious of the risk that by making some preliminary rulings we may be courting reversal by the Supreme Court and the need of starting all over again; we simply think the danger of this to be less serious than the consequences of letting

the special masters proceed as some of the parties have proposed, see fn. 5. Indeed, as this Memorandum progresses, the need for our making a considerable number of preliminary rulings will become even more evident.

We add one final prefatory note. The complexity of this case, as revealed by the statements submitted to us, has convinced us that the many preliminary issues that must be considered are best addressed in several separate units. What follows is a delineation of these units, with instructions to the parties and intervenors as to how they should proceed as to each. For the convenience of the parties we annex a schedule of the dates fixed for various steps in these preliminary proceedings.

II. Questions which the Court can now decide without presentation of factual material.

There appears to be almost complete agreement that the Court may now decide, without taking any evidence, what we characterized in our March 9, 1976 letter as the "first set" of § 303 issues; indeed, there appears to be a fair amount of agreement how we should decide them. Accordingly we shall set these and some other matters for briefing and argument in accordance with the schedule outlined below:

Initial briefs - August 23, 1976
Answering briefs - September 21, 1976

Time requests for oral argument shall be filed with the answering briefs. In this and all other cases dealt with in this Memorandum and Order, the parties shall arrange for joint briefing and argument to the maximum extent possible and shall keep the length of briefs to the minimum. After studying the briefs and the time requests, the Court — perhaps after a pre-argument conference — will advise the parties of the time, place and organization of the argument.

In light of the statements, we deem it desirable to sharpen the issues as follows:[8]

(1) *"Public interest."* The first question raised in our March 9 letter concerned the nature of our responsibility under § 303(c)(1)(A) to determine whether the transfers and conveyances "are in the public interest . . . ," especially in view of the description of judicial review in the second sentence of § 209(a) and the statement on p. 187 of the Conference Report of January 23, 1976. Several parties suggest that we need only determine that Congress had a rational basis for enacting the Rail Act and make no suggestion that it did not. If that is right, this issue can be regarded as substantially out of the case. However, two other views emerge from some of the statements.

One of these is that the "public interest" test requires us to pass on the viability of ConRail. At the moment we do not understand why we need to do this, just how we should go about it, or what we could do if we decided in the negative since a major reconveyance does not appear to be feasible. If any parties espouse this view, they should develop it in briefs.

The other such view is that although the "public interest" test may have little or no significance for the main body of the conveyances, it may require us to pass on the inclusion of certain peripheral properties or to decide whether, if the Act be regarded as a condemnation statute, certain properties were taken for something other than a public use.[9] It is hard to consider the question *in vacuo*. Any transferor or security holder allowed to intervene who asserts this position shall include in its brief illustrative statements of the properties in respect of which such a claim is made and the supporting reasons; the answer of the Government parties need meet such claims only with respect to legal issues since evidence would have to be taken if the Court were to decide there is need to pursue the matter further. In other words, what the Court needs is factual material sufficient to enable it to decide

whether, if any such claims are made, they have sufficient legal merit to require further development of the facts.

(2) *Fair and equitable.* The second question propounded in the March 9 letter concerned the construction of the "fair and equitable" language in § 303(c)(1), especially in view of the facts (a) that if the consideration is "fairer and more equitable than is required as a constitutional minimum," § 303(c)(3) requires us to eliminate the excess, and (b) that if the consideration were less than the constitutional minimum, it would not be fair and equitable.

Almost all, perhaps all, the statements seem to agree that the fair and equitable language serves no significant function in the determination of the value of any particular property, although several parties (including the Government parties) have suggested that this language may have a bearing on the allocation of ConRail's Series B Preferred and common stock. There is no need to rule on the latter suggestion now, since it will not be a matter for immediate consideration by the masters. Accordingly the Court will consider the "fair and equitable" issue to have been removed from the process of valuing the properties of individual estates or other transferors unless this is raised in the briefs to be filed as above indicated; any person taking such a position shall state with precision and not merely in conclusory terms how the "fair and equitable" test differs from the constitutional minimum test with respect to valuation in the context of the Act as it now stands.

The March 9 letter also raised the question whether the Court was bound to ascertain by what amount the consideration was less than fair and equitable and, by the same token, less than the constitutional minimum, even though the Court might have no effective way of remedying the defect. Further consideration had led us to an affirmative answer even before receipt of the statements; several of these suggest this and none opposes. Accordingly there is no need to brief this issue.

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We pass now to certain other questions of law which we believe the Court may now be able to decide, without taking evidence. These should be briefed and argued in accordance with the schedule set out on [CA-53].

(3) *Reorganization vs. eminent domain statute.* Although not raised in the March 9 letter, a question lurking in the case is whether the standard of valuation[10] should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both. At the moment the Court does not perceive that it should be. Any parties taking a different view should include arguments on that score in their briefs. Some parties also intimate that there may be different procedural requirements if the Act is regarded as an exercise of eminent domain; any party taking this view should brief it.

(4) *Reckless or deliberate disregard.* We include this item in the list, although it may not fit the caption. In the last paragraph of the March 9 letter, we stated we would "like to be promptly advised whether USRA, the United States, ConRail, or any other party represented on LC (Liaison Committee) takes the position that the last sentence of § 209 (e)(1) has any application in proceedings under § 303(c)(1)(A) and (B) or 306 (c)(4)" since, if they did, the Court would desire to receive briefs and hear argument on the statutory and constitutional questions that would be raised. USRA has advised the Court that it does not take that position. Unless any party advances that position in its opening briefs, see [CA-53], the Court will consider that the taking of such a position with respect to proceedings under the cited sections is foreclosed.

(5) *Method of handling the valuation of property not owned by a primary debtor.* The discussions of valuation in the statements of the primary debtors and their security holders seem to assume, without detailed discussion, that the properties are first

to be valued for each estate and that the total will then be distributed, in some way not clearly defined, as between the constituent transferors. This is an almost necessary consequence of the view, espoused by several primary debtors and their security holders, that the transferred property is to be valued as a going concern, and also conforms to what we understand to be the general practice in condemnation proceedings. The FSP, Vol. I, pp. 126, 145, shows separate values for each of the subsidiary debtors of Penn Central, and Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 gives a more detailed breakdown. The statements filed by the lessors seem to assume that they will receive the full value of their properties, without regard to the interest of the lessees; we have not been informed of the position of the latter. It may be that we have here a whole new set of issues which have thus far received relatively little thought.

The Court confesses it is somewhat baffled by the problem which bears, among other things, on the number and the duties of the masters to be appointed, and would welcome detailed proposals and briefing, even though it may be premature to attempt a definitive decision at this time. All parties desiring to express views on how this problem should be handled shall file briefs not later than August 23, 1976, answering briefs not later than September 21, 1976, and time requests for oral argument along with the answering briefs. The Court will then determine what further proceedings shall be had.

III. "Net Liquidation Value."

It is clear that, under § 306(c)(4), the Court is bound to determine the net liquidation value to which the transferors are entitled by virtue of transfers of rail properties to ConRail under § 303(b)(1) as a step in determining the BV of the CV's, whether the value of the securities (including the CV's) issuable

to the transferors is the same as or more or less than the Constitutional Minimum Value (CMV). The statements, however, reveal serious differences of opinion how this task should be performed.

A.

USRA's approach is summarized in FSP, Vol. I, pp. 124-26, and is stated in considerable detail in an Appendix, Vol. I, pp. 141-55. The essence of USRA's method is captured in the following paragraphs on p. 125:

> To resolve these and other issues, USRA postulated a "master liquidation plan" describing in detail an orderly process for the disposition of each estate's assets. The key assumption of the plan is that the estates would be required to sell substantial assets for continued rail use but that the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses. USRA assumed further that because of the valid requirements of common carrier regulations, the estates would operate under subsidies, if need be, and maintain their rail operations until 1979, at which time the orderly liquidation would begin. This subsidy period is also consistent with the self-interest of the estates in maintaining healthy price levels for their assets. USRA's plan also makes the favorable assumption that orderly cessation actually occurs and, therefore, prices are not adversely affected by the economic dislocations which would result if the actual service termination were abrupt and not orderly. The master liquidation plan also recognizes the physical requirement for preparing assets for sale and their effect on the timing of asset disposition.

> In essence, then, the liquidation plan postulated by USRA is for an orderly transfer of the transportation services provided by the estates to other railroads with the prices of such transfers computed as if the estates had actually been allowed to exercise their asserted right to liquidate by selling all of their assets for nonrail uses. The pricing under the assumption of total liquidation is based on supply and demand conditions which such a time-phased liquidation of rail assets into nonrail uses would produce. The pace of such asset disposition is tied to the time required to accomplish a transition to alternate modes and to prepare assets for sale.

We have no doubt that this is one theory of determining net liquidation value that must be considered. However, as indicated in the March 9 letter, even if USRA's general theory were to be accepted, its calculations depend on a considerable number of assumptions which are open to contest.

We cite as examples, but without limitation, "[a]ssessments of the time and cost of preparing the assets for sale, and the expected time required to dispose of such assets once prepared for sale in light of supply and demand conditions" (p. 125); "[t]he overall economic environment within which these activities would occur" (p. 125); the method for arriving at the discount factors stated at p. 126; the details of the calculations as to when all necessary authority to sell rail properties would be obtained, pp. 145-46 (including the question whether, if certain transferors would have been obliged to shut down for lack of funds, any such authority would have had to be obtained); what was done in regard to properties that may be "rail properties" within the Act but are not in the sense that authority to sell would have to be obtained; and the assumptions with respect to the determination of the value of rolling stock (pp. 146-48), facilities (pp. 148-49) and real estate (pp. 149-51).

Appendix B

In order to avoid wildly conflicting approaches by the masters appointed to deal with particular transferors, it seems essential that the Court, perhaps with the assistance of one or more Special Masters, should pass on the general validity of these assumptions, even though we recognize that any decision on this would simply establish something like a presumption which could be challenged by any transferor, e.g., by showing that it could have obtained authority to abandon at a date earlier than that hypothesized by USRA (or would not have required such authority because of lack of funds or for other reasons) or that it was in a peculiarly favorable position to sell rail ties. The transferors insist that before anything can be done in the way of briefing, there must be extensive discovery of the details of USRA assumptions and the basis for them.

While we agree that some discovery is needed before there can be any effective briefing, we believe this should be in two stages. The first stage would be devoted to general questions such as those we have outlined. The second stage, which could go on while we were considering these general issues, would relate to more specific matters, e.g., the correctness of the count of rolling stock, track, etc., or the validity of the choices of other real estate sales selected to determine market value.

USRA has now taken an important first step by serving on the parties copies of its Master Liquidation Plan and of five valuation reports. While we do not anticipate that these will satisfy transferors even with respect to first stage discovery, this submission should suffice to enable them to formulate requests, which can then form the subject of consideration by the Acting Liaison Committee, substantially as proposed in the June 7, 1976 response of the Government parties, pp. 13-15. We direct the parties and the Acting Liaison Committee to proceed along these lines with respect to what we have characterized as first stage discovery of NLV methodology used by USRA and by any of the transferors and the Acting Liaison Committee to report to us no later than August 23, 1976.

B

We now turn to another and more basic matter. The chief quarrel on the part of the transferors and security holders with USRA's general approach to the determination of NLV, summarized in the paragraph quoted from FSP. Vol. I, p. 125, as distinguished from the subsidiary assumptions leading to the final figures, and also as distinguished from the question whether CMV is higher than the value of the securities issuable to the transferors, relates to the second sentence. Many of the statements claim that, at least for certain properties, the maximum liquidation price would be attained by selling them for railroad use.[11]

We do not understand that the statements of the Government parties altogether dispute this, see pp. 12-17 of the opening statement and pp. 9-12 of the responsive statement. After outlining a formidable series of hurdles that, in their view, a transferor would have to overcome before he could establish that sale to another railroad would yield more than sales for non-rail use, and urging that on this account, "the Court should presume that no hypothetical combination of dispositions would have produced a value higher than that attainable in a disposition of all of the transferred properties for nonrail use," they concede that "[t]his presumption could be overcome by a showing by a transferor that . . . it could and would legally and feasibly have disposed of some or all of its properties, for rail use, at a value determined other than by reference to the value attainable in a liquidation for nonrail use," (p. 17).

The Government parties argue that before any transferor can be allowed even to attempt this showing, there must be a preliminary proceeding in which, as we understand it, all transferors seeking to make the attempt must develop a consistent "alternative scenario" and the Court is to pass upon its feasibility, considered as a whole. While the presentation of such a plan would greatly facilitate our consideration, the Government parties have

not indicated how we could compel this. At the moment we are not persuaded that the procedure proposed by the Government parties is necessary or even feasible. The subject can be more intelligently considered when we know what transferors intend to show more advantageous dispositions for rail use and with respect to what properties.

Before we request transferors to advance their proposals, there seems to be a point of law the decision of which will importantly affect the proceedings. Several transferors appear to include in their claim that NLV should take account of higher prices obtainable for rail than non-rail use not only sales of certain properties to solvent railroads (or other private groups if any such were possible purchasers) but also sales of other properties to public bodies vested with the power of condemnation. At the moment we do not understand why in the absence of competing private purchasers, such public bodies could be expected to pay more than the NLV for nonrail use.[12] We think this question can be usefully briefed, argued and decided along with those enumerated in Part II, Items (1), (2) and (3). The question is this:

> Assuming that in determining "net liquidation value" as used in § 306(c)(4) the Court should take account of a higher price obtainable for certain properties on a sale for rail use rather than, as USRA proposed, "at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses" (FSP, Vol. I, p. 125), should the Court do this when the proposed sale is to a public body vested with the power of eminent domain, in the absence of proof of a private purchaser ready and willing to make the purchase?

Once the Court answers this question, the next step would be to require the transferors to enumerate the possible transfers they

desire to have considered. It may be that, as suggested by the PC Trustees (p. 23), the transferors will require the aid of discovery to assist them in doing this; the Government parties say that on this and other subjects discovery should be reciprocal. USRA could expedite matters if it would promptly make available to transferors any information which it has in regard to the interest (or lack of it) displayed by private parties in acquiring parts of the properties conveyed to ConRail, including the history of the aborted negotiations with the Chessie and the Southern; the transferors should similarly make available to the Government parties facts as to efforts made by them to effect such sales. The mechanics for this should be discussed in the Acting Liaison Committee and included in the report directed above. When the transferors have formulated their proposals, it may well be desirable to utilize the two-phase process suggested by the PC Trustees — a first phase in which the Court, perhaps aided by a Special Master, would determine the feasibility of the proposed transfers, and a second phase ascertaining the prices that would have been obtainable.

A number of the transferors have advanced theories for determining NLV that seem to have nothing to do with "liquidation," particularly in the light of the discussion at p. 199 of the Conference Report. As at present advised, we believe that the place for these theories is in the consideration of the constitutional minimum, which we will discuss in Part V of this Memorandum. The briefing and argument of the validity of these theories which is there directed can include the point raised in the two preceding sentences.

IV. Other problems in arriving at the Base Value of the Certificates of Value.

Since the discussion in Part III has taken us a considerable distance into the problems of § 306(c)(4), it will be convenient to

complete our discussion of that section before returning to § 303(c)(1).

We think it would be desirable to separate the determination of BV into its three component parts, NLV, VOB, and CUE. We take it that Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 broadly reflects the position of the Government parties as to NLV. Any further revisions to take account of additional designations, property sales, and the changed conveyance date should be made promptly.

USRA has outlined its theories as to the determination of VOB in FSP, Vol. I, pp. 128-34. However, the FSP says that it had been "impossible within the statutory deadlines to arrive at any final quantification as to all categories of 'other benefits'"; that the figures given are at least in part "estimates and approximations"; and that USRA's "analysis will continue as regards both the quantification of established categories and the possible identification and quantification of additional categories." Most of the transferors claim that there are no, or few, "other benefits"; they also say that the failure of FSP to trace how the general principles stated on pp. 128-33 were translated into the figures in Tables 2 and 3 makes it impossible for them to voice their objections intelligently.

We think there is merit in the latter point, at least to the extent that the argument would be more meaningful if more details were known. We therefore direct USRA to prepare and file a more detailed explanation and calculation of VOB, taking such account as it thinks warranted of the criticisms in the statements. The objective would be to provide a statement in sufficient detail that we could rule on the issues of principle (i.e., whether a particular category did or did not constitute a benefit) on the basis of USRA's statement and opposing affidavits going into principle rather than detail and thereby eliminate, as to categories we might rule out, the need for further discovery or factual presentation. USRA is directed to file such a statement not later than

December 1, 1976. Again we urge USRA to be as forthcoming as feasible in its statement; the more that is voluntarily disclosed, within the realm of reason, the better are the chances for our being able to issue instructions to the masters without unnecessary advances discovery and taking of evidence. We also take note of the contention of some transferors that the benefits, in whole or in certain categories, are negative, and the legal problem arising therefrom. We believe that, at the appropriate time, this also can be handled by briefs supplemented with illustrative factual material — not in the sense of determining precise figures but in that of deciding whether the contention that "negative benefits" should be added rather than subtracted, or the more modest proposal that a "negative benefit" in one category is to be offset against positive benefits in others, are legally sustainable.

Turning to CUE, it now appears to us that there are three sets of legal issues which can be determined without awaiting the completion of detailed studies on the subject; indeed a relatively early resolution of these issues is essential in order to enable us to direct what studies should be prepared, since USRA contends that there has been no CUE.

Two of these issues concern the period of erosion claims. The statement of the Government parties takes the position, p. 28 n.19, that there can be no valid erosion claim for any period prior to enactment of the Rail Act — a position finding at least some support in our earlier opinion, 384 F. Supp. at 925. The transferors disagree. Secondly, some transferors take the position that there can be valid erosion claims for periods after the March 31, 1976 conveyance with respect to property not conveyed. The Government parties presumably disagree. The third concerns the nature of the items qualifying as erosion claims. The statement of the PC Trustees (pp. 11-12) helpfully subdivides erosion into "financial erosion" and "physical erosion." The former would include the four items mentioned in our earlier opinion, 384 F. Supp. at 923, and possibly others of similar nature. Physical erosion is the deterioration of plant which may result in a

lower NLV for the properties conveyed and lower realizable values for those not conveyed. We think the two issues of dates and the issue of the nature of the items qualifying for treatment as CUE can be resolved, or at least narrowed, as a matter of principle on the basis of factual submissions without the taking of detailed evidence since we would not anticipate serious conflict on the facts. We direct that all persons making claims of CUE shall file not late than October 18, 1976 detailed statements with supporting briefs which shall include the following:

(1) The date when they contend that valid erosion claims began. These should be supported by inclusion of petitions, reports and orders in the various reorganization courts and financial data that are claimed to be relevant.

(2) Any date later than March 31, 1976 to which they contend that erosion continued. The statements should give some idea of the nature and amount of any such post-conveyance erosion claims and shall present the legal theory contended to support them.

(3) The categories (and some approximation of the amounts) of erosion claims.

The Government parties shall answer not later than November 15, 1976, and the claimants may reply not later than December 7, 1976. The Court will then set a date for argument.[13]

V. Constitutional Minimum Value.

While, as mentioned in Part III of this Memorandum, Congress was of the opinion, Conference Report p. 199, that by providing for CV's it had assured the transferors of the constitutional minimum, that opinion is, of course, not conclusive. As also mentioned in Part III, we are presently of the view, while this is subject to change after brief and argument, that when Congress

spoke of liquidation, it meant liquidation, although liquidation is not necessarily sale exclusively for nonrail use. Unless further briefing and argument should alter the view stated in the preceding sentence, we would consider, as previously indicated, that many of the contentions with respect to an expansive notion of NLV should rather be regarded as contentions that even an application of NLV taking full account of possible dispositions for rail use may not produce values equal to the constitutional minimum.

It would seem that if a railroad (or a segment which would have been allowed to operate pruned of unprofitable extensions) has capitalized earning power in excess of NLV, even in the "world" where most of the rail service provided by the bankrupt estates has ceased, the Constitution would require payment on that basis. If the Government parties contest this proposition, or desire to frame conditions about it which they believe we should impose as guidelines to the masters, they should include a discussion of this in their opening briefs.[14]

Apart from this the statements and answers can be said generally to reveal the clash manifested by the majority and dissenting opinions in *In the Matter of the Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734 (1967). Putting the matter in another way, they raise the issue whether and, if so, how far the Supreme Court would consider that the situations here presented require a departure from the standard that in condemnation "the question is what has the owner lost, not what has the taker gained," *Boston Chamber of Commerce* v. *City of Boston*, 217 U.S. 189, 195 (1910), and subsequent decisions. We see no reason why we cannot formulate at least a general position on this subject without requiring the special masters to take detailed evidence on some or all of the many theories of valuation that would run afoul of the quoted standard if this is applicable. In saying this we do not mean to limit the parties to ordinary legal briefs. If any party believes it would be helpful to accompany its brief by affidavits or offers of proof, it may do so; the Court will consider these not as proof of the facts stated but for the light they

shed on the legal issues. Such a course will meet the Supreme Court's comments in *Regional Rail Reorganization Act Cases*, 419 U.S. 102,146 (1974), without requiring the vast expenditure of time and money that would follow from our leaving the issue of the constitutional minimum wholly at large until the masters have reported.

That issue, as we now see it, is whether the Constitution requires any valuation in excess of NLV properly defined, and as then used in § 306, plus any higher valuation of a railroad or segment derivable under the second paragraph of this Part V. Illustrative of the theories of valuation that would seem to fall if that question were to be answered in the negative are those propounded as theories of NLV in the statements of the Trustees of the Lehigh Valley, pp. 11, et seq.,[15] of the Erie Lackawanna, pp. 11, et seq.,[16] and of the Penn Central Trustees, pp. 9-11; those propounded as theories of the constitutional minimum in the statements of the Penn Central Lienholders, pp. 9, et seq.,[17] and the Committee of Secured Rail Creditors in the Penn Central Transportation Company Reorganization Proceedings;[18] the "true economic value" theory of the Penn Central Company; and the theory of the New Haven Trustee.[19] We emphasize that by mentioning the contentions of these parties as illustrations we are not relieving others who contend for a value higher than that formulated in the first sentence of this paragraph.[20]

There are three subsidiary issues that appear to require special briefing:

The first is this: Assuming that our answer to the question put above were to be generally in the negative, are there specific properties as to which valuation on the basis of NLV or a higher value based on capitalized earnings would be so manifestly unfair, because both factors work out at or near zero, that a higher value must be found and, if so, on what basis? This is essentially the question put by Judge Keating with respect to the Hudson River tunnel properties in *In the Matter of the Port Authority Trans-Hudson Corp., supra*, 20 N.Y.2d at 470, 231 N.E.2d at 739-40.

While long tunnels of this sort are the paradigm, the transferors are invited to suggest other categories.

A second question, raised by the statement of the New Haven Trustee, is whether there is any requirement that the properties conveyed by the New Haven to PC should be valued on any higher basis than other properties.

A third issue, raised explicitly by the Lehigh Valley Trustee (pp. 23-24) but potentially of broad application, is whether the Constitution requires that compensation be given for any diminution in value of the assets severed and then left with the transferors, on a theory of inverse condemnation or otherwise. Here again, we would expect those propounding this point to give sufficient examples to enable the Court to understand the nature of the claimed diminution, not necessarily in dollar amounts but by categories.

We recognize the possibility that, after the briefing and argument here directed, we may decide that some of the issues propounded in this Part V are not ripe for decision, or may determine to afford the Special Masters greater leeway (possibly in the form of permitting requests for further instructions) than we now contemplate. Nothing will have been lost, however, since the issues set forth in this Part V will have to be briefed and argued at some time in any event, and the benefit attainable from our ruling in 1977 rather than many years later, after prodigious efforts before and by the special masters, which may be unnecessary, is so tremendous.

Recognizing that the issues raised in this Part V are of great consequence and that factual materials may need to be assembled, we shall allow considerably more time for the filing of papers. We set the following schedules:

Presentation of proponents - January 6, 1977

Presentation of Government parties - February 20, 1977

Replies of proponents - March 18, 1977

We shall defer fixing a date for argument until the papers have been filed.

VI. Petitions for leave to intervene.

In view of the large number of parties entitled to participate in these proceedings as a right, the Court cannot be as liberal in granting interventions as it might like to be. Indeed in some ways the intervention of creditor and stockholder interests may be counterproductive; insofar as they merely repeat arguments already ably made by transferors, they diminish the force of the latter. Paraphrasing Mr. Justice Stewart's well-known remark in *New York Times Co.* v. *United States*, 403 U.S. 713, 729 (1971), when everyone is heard, no one is heard. We are also mindful of the considerations concerning expense mentioned in Part I of this Memorandum. We are therefore granting intervention in these proceedings for the establishment of general principles to intervenors who have demonstrated a legal interest in the outcome and have taken or propose to take positions different from that taken by the transferors. When interventions shall be granted in proceedings relating to the application of the general principles to specific properties can be determined later.

Applying this criterion, we grant intervention in the proceedings provided for in this Memorandum and Order to the following:

Institutional Investors Penn Central Group and certain Penn Central Indenture Trustees.

The First National Bank of Chicago as Trustee under First Mortgage Indenture of the Chicago River and Indiana Railroad Company, for the limited purpose of presenting arguments pertaining specifically to the C.R. & I.

Provident National Bank and A. Wakelee Swartz, Jr., as Indenture Trustees for Pennsylvania Tunnel and Terminal Railroad Company, and the Bank of New Jersey, as

Indenture Trustee for New York Connecting Railroad Co., for the limited purpose of presenting arguments pertaining specifically to the named railroads.

Citibank, N.A., as Agent for the Committee of Secured Bank Creditors in the Penn Central Transportation Company Reorganization Proceedings, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the theory of valuation discussed in its petition and accompanying statement.

Richard Joyce Smith, Trustee of the Property of the New York, New Haven & Hartford R.R. Co., for the limited purpose of presenting contentions pertaining specifically to properties transferred by the New Haven estate to Penn Central.

Penn Central Company, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the issues outlined in its petition and accompanying statement.

The following applications are denied for lack of a sufficiently specific showing of inadequacy of representation by other parties in the proceedings provided for in this Memorandum and Order and, in some instances, for failure to file a statement of contentions as required by this Court's order of April 26, 1976:

Joint Application of Morgan Guaranty Trust Company of New York and eight other indenture trustees of Erie Lackawanna Railway Company

Joint Application of Girard Trust Bank and four other indenture trustees of Lehigh Valley Railway Company.

Petition of John W. Sullivan, John D. Mabie, and Thomas A. Reynolds, Jr., minority stockholders of Reading Company.

Appendix B

Petition of Minority Stockholders of Mahoning Coal Railroad Co.

Petitions for leave to intervene have been filed on behalf of five governmental bodies listed in the margin.[21] As to almost all of the questions set forth in this memorandum, we fail to see that these bodies have an interest justifying even permissive intervention; the only exception would be if a contention were to be made that some of the transfers were not in the public interest, see Part II (1). These petitions are denied without prejudice to applications for limited intervention in the event indicated.

This constitutes an order; the parties shall proceed in accordance herewith.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge /

June 16, 1976

Appendix B

FOOTNOTES

1. The Court has adopted a new caption and docket number for general matters relating to the valuation proceedings under §§ 303(c) and 306. All papers subsequently filed in general proceedings dealing with valuation shall bear this caption and docket number. The Court will enter an order transferring from Docket Misc. No. 75-3 matters relating to these general valuation proceedings and also breaking Misc. No. 75-3 into various categories.

2. We use the term "securities" to include other forms of consideration moving to a transferor.

3. The problems would have been less under the bill as passed by the Senate which used the phrase "constitutional minimum" instead of NLV.

4. The valuation of the New Haven took four years even though there was general agreement that the property should be valued primarily on a scrap value basis.

5. Thus the statement on behalf of Reading Company and its wholly-owned subsidiaries says (p. 13):

> Therefore, the only proper instructions that this Court can give the Special Masters is to hear all evidence pertaining to value each party desires to introduce and to structure the appropriate theory of valuation at the end of the proceeding.

6. We use this term to include indenture trustees.

7. For present purposes, we include ConRail along with the United States and USRA in the term "Government parties."

8. It should be clearly understood that any expressions in this Memorandum and Order which relate to the merits or to procedures not herein prescribed are designed solely to assist in structuring these proceedings and do not indicate a prejudgment.

9. Here, as elsewhere in this Memorandum, we will take it for granted that parties who wish to establish that a question that has been raised has constitutional as well as statutory dimensions will develop the point in their briefs.

10. We use this phrase so as to exclude for present purposes the question whether to the extent that the statute is an eminent domain statute, as the non-bankrupt transferors claim is necessarily is as to

them, and as some other parties claim as well, the Constitution requires that the consideration be paid in cash.

11. This contention is to be distinguished from the argument that for certain segments the "highest and best use" would be retention by the transferor for railroad purposes. This sounds rather on the claim that CMV may exceed the value of the securities issuable to the transferors, although a determination of capitalized earnings would have evidentiary value for both.

12. Except, of course, in a situation similar to that envisioned in fn. 11.

13. The Trustee of the Ann Arbor has raised an issue of law peculiar to it. Since this estate has conveyed no property to ConRail, it will not obtain CV's. The Trustee wishes us to decide whether we have power to enter a deficiency judgment for CUE under § 303(c)(3) and direct payment by the United States under § 303(c)(5). If we should decide in the negative, the Trustee would like to proceed directly in the Court of Claims. We think it preferable to defer decision on this at least until we have passed on the general questions with respect to erosion outlined above.

14. In our 1974 opinion, 384 F.Supp. at 928 n.61, we took note of a theory which we thought to be then suggested by the Government parties, namely, that the constitutional minimum might be less than liquidation value in the case of a railroad (or perhaps a segment) with earnings which were sufficient that it could not obtain permission to abandon but whose capitalized value was less than liquidation value. The Government parties do not now seem to urge this except for making the point that if ConRail has sufficiently large earnings, there may be no need for determining net liquidation value. If the Government parties wish to preserve the contention adverted to in the cited footnote, they should also include an argument on this in their opening briefs.

15. Real estate at fair market value plus an assemblage factor:

Improvements at the higher of a scrap value or going concern value:

Going concern value measured by a combination of:

Capitalized prospective earnings

Public usefulness (the price of reconstruction or of a substitute facility)

RCNLD in appropriate instances

Value in place (i.e., scrap value with no subtraction for dismantling).

16. Capitalized earning power as basis for sale to another railroad;

Gross liquidation value (i.e., no cost for dismantling) as basis for sale to another railroad;

"Special Value" to a public body (e.g., a state) calculated by some combination of:

Depreciated value of track

Market value of land, plus assemblage factor

Gross liquidation value

Value of a developed operating organization

Value of not having to develop more costly alternatives

RCNLD of special facilities;

"Residual Value"—i.e., value as an integrated network.

17. Value properties as an assembled unit (i.e., apparently as a "going concern") by an appropriate combination of:

Land at fair market value plus assemblage;

Track at depreciated value;

Related facilities at cost plus appreciation;

Intangibles at cost of production less obsolescence;

For special facilities, RCNLD;

Value to public in terms of costs of alternatives.

18. "[W]hat it would have cost an acquiring entity on April 1, 1976 to buy, in an arm's length transaction, the conveyed real estate and to then build an integrated rail system . . . on that real estate . . . . (p. 4)"

19. Presumption of reconstruction cost new less depreciation unless the Government parties rebut this.

20. We have not mentioned the contentions of the Government parties as to "ConRail use value" since we do not understand their precise relevance. If the Government parties wish these to be considered as part of the proceedings here contemplated, they should make a further submission on the subject not later than August 15, 1976.

21. The Commonwealth of Pennsylvania, the State of Delaware, the Department of Transportation of the State of New York, the Maryland Department of Transportation and the City of Philadelphia.

Appendix B

Schedule

Subject

(1) "Public interest"; "fair and equitable"; reorganization vs. eminent domain statutes, reckless or deliberate disregard clause, § 209(a)(1)—see Part II, Items (1), (2), (3) and (4); relevance of possibility of sale for rail use to public bodies having power of condemnation, see Part III.

Opening briefs—August 23
Answering briefs—September 21

(2) Method of handling the valuation of properties not owned by primary debtors, see Part II, Item (5).

Opening briefs—August 23
Answering briefs—September 21

(3) Report by Acting Liaison Committee with respect to first stage discovery on NLV methodology and on efforts by USRA and transferors to effect sales for rail use to private parties.

August 23

(4) Date on which USRA shall file detailed statement of value of other benefits.

December 1

(5) Filing by transferors of statements and briefs with respect to uncompensated unconstitutional erosion: October 18

Response by Government parties: November 15
Replies: December 7

(6) Briefs (accompanied by affidavits or offers of proof) on constitutional minimum.

Opening briefs—January 6
Answering briefs—February 20
Reply briefs—March 18

APPENDIX C

Appendix C

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed April 19, 1977, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS
UNDER §§ 303(C) AND 306 OF THE
REGIONAL RAIL REORGANIZATION ACT.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

David B. Isbell, Esq., Washington, D.C. (Edwin M. Zimmerman, Esq., Jeffrey S. Berlin, Esq., Jeffrey G. Huvelle, Esq., and Covington & Burling, Esqs., Washington, D.C.; John B. Rossi, Esq., Philadelphia, Pa., of Counsel), for Penn Central Trustees and Certain Affiliated Transferors.

David C. Toomey, Esq., Philadelphia, Pa. (Jared I. Roberts, Esq., and Duane, Morris & Heckscher, Esqs., Philadelphia, Pa., of Counsel), for Trustee of the Lehigh Valley Railroad Company.

Harry G. Silleck, Jr., Esq., New York, N.Y. (John L. Altieri, Jr., Esq., and Mudge Rose Guthrie & Alexander, Esqs., New York, N.Y., of Counsel), for Trustees of Erie Lackawanna Railway Company, and Certain Affiliated Non-Bankrupts.

Stanley Weiss, Esq., Newark, N.J. (M. Elaine Jacoby, Esq., Dean R. May, Esq., and Carpenter, Bennett & Morrissey, Esqs., Newark, N.J., of

Counsel), for Trustee of the Central Railroad Company of New Jersey.

Louis A. Craco, Esq., New York, N.Y. (Walter H. Brown, Jr., Esq., Thomas L. Bryan, Esq., Michael B. Targoff, Esq., Rebecca T. Halbrook, Esq., Richard L. Posen, Esq., and Willkie Farr & Gallagher, New York, N.Y.; Frederic L. Ballard, Sr., Esq., and Ballard, Spahr, Andrews & Ingersoll, Esqs., Philadelphia, Pa., of Counsel), for Intervening Penn Central Lienholders.

Joseph Auerbach, Esq., Boston, Mass. (Morris Raker, Esq., Thomas Wardell, Esq., Thomas D. Halket, Esq., Harvey E. Bines, Esq., and Sullivan & Worcester, Esqs., Boston, Mass.; James Wm. Moore, Esq., New Haven, Conn. of Counsel), for Trustee of The New York, New Haven and Hartford Railroad Company.

Howard H. Lewis, Esq., James A. Sox, Esq., and Obermayer, Rebmann, Maxwell & Hippel, Esqs., Philadelphia, Pa.; Lockwood W. Fogg, Jr., Esq., Plymouth Meeting, Pa., for Trustees of the Reading Company and for its Wholly-Owned Subsidiaries.

Timothy V. Smith, Esq., New York, N.Y., for Trustee of The Lehigh and Hudson River Railway Company.

Joseph J. Connolly, Esq., and Goodman & Ewing, Esqs., Philadelphia, Pa.; Herbert G. Schick, Esq., and Hepburn, Ross, Willcox & Putnam, Esqs., Philadelphia, Pa.; Jerome K. Walsh, Esq., and Walsh & Frisch, Esqs., New York, N.Y., for Secondary Debtors of The Penn Central Transportation Company.

Charles I. Thompson, Jr., Esq., Philadelphia, Pa., for The North Pennsylvania Railroad Company, the Delaware and Bound Brook Railroad Company, and Philadelphia, Germantown and Norristown Railroad Company.

Perrin C. Hamilton, Esq., and Hamilton, Darmopray & Malloy, Esqs., Philadelphia, Pa., for the East Pennsylvania Railroad Company.

Alan C. Kauffman, Esq., and Obermayer, Rebmann, Maxwell & Hippel, Esqs., Philadelphia, Pa., for the Peoria and Eastern Railway Company.

Joseph S. Radom, Esq., and Thomas B. Radom, Esq., for Trustee of the Ann Arbor Railroad Company.

George F. Galland, Esq., Robert W. Ginnane, Esq., and Galland, Kharasch, Calkins & Brown, Esqs., Washington, D.C., for Norwich & Worcester Railroad Company.

William T. Lake, Esq., and Louis R. Cohen, Esq., Washington, D.C. (Lloyd N. Cutler, Esq., William R. Perlik, Esq., David R. Johnson, Esq., and Wilmer Cutler & Pickering, Esqs., Washington, D.C.; Kevin P. Charles, Esq., Robert H. Kapp, Esq., Howard R. Moskof, Esq., George W. Mayo, Jr., Esq., and Hogan & Hartson, Esqs., Washington, D.C.; Cary W. Dickieson, General Counsel, Stephen C. Rogers, Deputy General Counsel, and Jordon Jay Hillman, Special Counsel, United States Railway Association, Washington, D.C., of Counsel), for United States Railway Association.

Appendix C

Paul M. Tschirhart, Esq., Department of Justice, Washington, D.C. (Rex E. Lee, Assistant Attorney General, and John H. Broadley, Esq., Dept. of Justice, Washington, D.C.; Donald T. Bliss, Deputy General Counsel, Alexander P. Humphrey, Esq., and Justine Fischer, Esq., U.S. Dept. of Transportation, Washington, D.C. of Counsel), for United States of America.

Appendix C

FRIENDLY, Presiding Judge:

I. INTRODUCTION

Section 303(c)(1)(A) and (2) of the Regional Rail Reorganization Act of 1973 as amended (the Rail Act) directs this court to determine whether the transfers and conveyances which took place on April 1, 1976, were for a consideration more or less than the constitutional minimum[1] "taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have occurred in the estate of each such railroad, during the bankruptcy proceeding with respect to such railroad".[2] Section 306(c)(4) provides that one item to be included in the base value of each series of certificates of value (CV's) authorized by § 306 shall be "such amount, if any, as the special court may determine shall be required after taking into consideration compensable unconstitutional erosion, if any, in the estate of a railroad in reorganization, or of a railroad leased, operated, or controlled by such a railroad, which the special court finds to have occurred during any bankruptcy proceeding with respect to such railroad".[3] These provisions appeared for the first time in the amendments made by the Railroad Revitalization and Regulatory Reform Act of 1976 (RRRRA), evidently in response to indications in our opinion of September 30, 1974 (180-Day Appeals), 384 F. Supp. 895, 918-26, and the Supreme Court's opinion in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 122-25 (1974), that the process provided by the Rail Act might involve what the Supreme Court called an "erosion taking" of property of the transferors for which the Fifth Amendment would require just compensation. Because of the limited powers accorded us by the original Rail Act with respect to securities issuable to the transferors, those opinions envisioned that the task of determining the existence and amount of such erosion would devolve primarily upon the Court of Claims under the Tucker Act, 28 U.S.C. § 1491; the effect of the 1976 amendments was to

transfer that task, or at least the bulk of it, to this court.[4] The claims are large; and approximation of the claim of the Penn Central Trustees for pre-conveyance erosion runs to nearly $900 million.

In our Memorandum and Order of June 16, 1976, Directing Preliminary Proceedings for the Determination of General Principles under §§ 303 and 306 of the Act (June 16 Memorandum), we identified "three sets of legal issues" with respect to compensable unconstitutional erosion (CUE) which we thought could be presently "determined without awaiting the completion of detailed studies on the subject".[5] 425 F. Supp 276, 284-85. These were:

> (1) The date when the transferors contend that valid erosion claims began;
>
> (2) Any date later than March 31, 1976 to which the transferors contend that erosion continued:
>
> (3) the categories (and some approximation of the amounts) of erosion claims[6].

Consideration of the briefs and arguments has led us to conclude that it would be best to defer decision on the item of post-conveyance erosion claims, identified above as (2). These claims fall into three categories— interest on loans made pursuant to § 211(h); alleged inadequacy of rentals for property subject to rail service continuation payments under § 304(c)(2);[7] and erosion with respect to properties designated as "suitable for use for other public purposes" and required to be temporarily retained under § 304(b)(2). The nature of these claims is altogether different from pre-conveyance CUE claims; their amount, if any, is not now determinable; decision with respect to some (notably the second) may be dependent on later decisions in the valuation phase of the case; and failure to pass upon them at this time will

not delay the progress of these proceedings.[8] Both the Government parties and those transferors who spoke on the matter indicated a willingness to have us postpone consideration of these issues. We shall thus defer decision on them, with the proviso that at any time this court may, or any party may request us to, restore all or some of these questions to the active list, with proper notice and such further opportunity, if any, for additional briefing and argument as we may think appropriate.

We shall therefore deal in this opinion only with pre-conveyance CUE claims. As was suggested at the argument, we shall treat the brief of the Government parties as a motion for summary judgment that, subject to certain reservations hereafter noted, there are no valid claims. Further we shall deal in this opinion only with the issue of when, if ever, such claims began to accrue.

The organization of the balance of this opinion shall be as follows: In Section II, after a brief statement of the general nature of the claims, we shall set forth the history giving rise to the claim of the Penn Central Trustees. This will be followed by Section III in which we shall analyze the authorities. In Section IV we shall state our general conclusions in regard to the accrual of pre-conveyance CUE and apply these to the Penn Central. A further Section V shall deal with the claims of other bankrupt estates for pre-conveyance CUE, and in a final Section VI we shall make some concluding remarks.

II. The Nature of the Claims and the History Giving Rise to the Claim of the Penn Central Trustees

The term "compensable unconstitutional erosion" is a newcomer to the legal lexicon.

As recognized in our previous opinions, June 16 Memorandum, 425 F. Supp. at 284-85; see *In re Penn Central Transportation Company*, 384 F. Supp. 895, 923 (1974), "erosion" of estates such as those of the railroads here before us falls into two major

categories. Financial erosion arises from the creation of claims such as administration expenses, trustees' certificates, and taxes which have priority over the claims of pre-bankruptcy creditors, and use for operations of cash or property held as security for liens. Physical erosion consists of the depletion of property through such means as loss of nonescrowed cash and deterioration of physical plant, which result in the property having a lesser value at the end of the period than at the beginning.[9]

Erosion as such has no constitutional implications; it is suffered in some forms by many losing businesses outside bankruptcy as well as within it and by commercial or manufacturing enterprises as well as by public utilities. Unconstitutional erosion arises only when a losing business has been required to continue to operate against its will for more than a reasonable period.

It is not clear just what Congress considered it was adding by the adjective "compensable". Perhaps it was of the view that even unconstitutional erosion was not always compensable, but if so, it did not state what the critical factors were deemed to be. In the preceding paragraph we deliberately used the passive voice "has been required" and did not elaborate on the meaning of the verb "require". By adding the word "compensable" Congress may have meant to emphasize the importance of two elements that are implicit in the concept of "unconstitutional" erosion itself, namely, that the claimant should have made manifest its desire to quit operating and should have applied for authorization necessary to that end, and that some identifiable agency of government having power to do so should have thwarted its desires.

The principle underlying the claims for CUE derives from three Supreme Court decisions of the early 1920's, *Brooks-Scanlon Company* v. *Railroad Commission of Louisiana,* 251 U.S. 396 (1920); *Bullock* v. *Florida ex rel. Railroad Commission of Florida,* 254 U.S. 513 (1921); and *Railroad Commission of Texas* v. *Eastern Texas Railroad,* 264 U.S. 79 (1924). All three involved small railroads[10] whose business had become so unprofitable that they could not continue operations except at a loss.[11]

The Supreme Court held they could not constitutionally be compelled to do so. The most important single statement in these cases was Mr. Justice Holmes' in *Brooks-Scanlon*, 251 U.S. at 399:

> If the plaintiff [railroad] be taken to have granted to the public an interest in the use of the railroad it may withdraw its grant by discontinuing the use when that use can be kept up only at a loss.[12]

Efforts to distinguish these cases as inapplicable to large railway systems important to the public or to dismiss them as outmoded were rejected by the lower courts in the *New Haven Inclusion Cases, see New York, New Haven and Hartford Railroad First Mortgage 4% Bondholders' Committee* v. *United States*, 289 F. Supp. 418, 440-41 (S.D.N.Y. 1968); *In re New York, New Haven and Hartford Railroad*, 304 F. Supp. 793, 802-04 (D. Conn. 1969), *modified and aff'd sub nom. New Haven Inclusion Cases*, 399 U.S. 392 (1970); *New York, New Haven and Hartford Railroad First Mortgage 4% Bondholders' Committee* v. *United States*, 305 F. Supp. 1049, 1055 (S.D.N.Y. 1969), *vacated on other grounds sub nom. New Haven Inclusion Cases*, 399 U.S. 392 (1970); by the Third Circuit in the Columbus Option case, *In re Penn Central Transportation Company*, 494 F. 2d 270, 278-82, *cert. denied*, 419 U.S. 883 (1974); by this court on the 180-Day Appeals, 384 F. Supp. at 918-19; and most importantly, by the Supreme Court in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 122 (1974). The transferors claim to be entitled to pre-conveyance CUE from the date of "accrual" of their "*Brooks-Scanlon* rights"; the serious issues are whether these ever did "accrue" prior to conveyance and, if so, when.

The Penn Central Trustees contend that this accrual occurred on October 1, 1973, some three months before the Rail Act was

enacted. They base their claim on the history of the Penn Central reorganization proceedings. In extended summary this history was as follows:

The Trustees contend that Penn Central was in danger of collapse almost from the time it entered bankruptcy on June 21, 1970. On December 22, 1970, faced with an imminent total depletion of working cash, due in part to a retroactive wage increase mandated by Congress on December 10, 1970 in order to halt a nationwide strike, the Trustees petitioned the reorganization court, 325 F. Supp. 302 (E.D. Pa. 1971), for authority to issue $100 million of trustees' certificates to be guaranteed by the United States under the then proposed and shortly thereafter enacted Emergency Rail Services Act of 1970 (ERSA), 84 Stat. 1975. The petition was opposed by the Trustee of the New Haven, who had become a large creditor and stockholder as a result of the inclusion of the New Haven in the Penn Central, *see New Haven Inclusion Cases,* 399 U.S. 392 (1970), the indenture trustees of various mortgages, and stockholder interests. One of the § 77 Trustees testified there was a reasonable prospect that within three to five years the PC would be restored to "viability" in the sense of having some income available for the payment of fixed charges, 325 F. Supp. at 304. The Secretary of Transportation had likewise found, as required by ERSA, that "the railroad can reasonably be expected to become self-sustaining." *Id.* The reorganization court (Judge Fullam) granted the Trustees' petition. He found that this was "not a situation of attempting to require the railroad to be operated permanently at a loss," citing *Brooks-Scanlon*, although "[f]undamental statutory and administrative changes, affecting such matters as rate-making, abandonments or subsidization of uneconomical lines, and labor arrangements, will undoubtedly be required if continued viability of railroads, especially Eastern railroads, is to be assured."

In a report dated February 10, 1971, the Trustees affirmed that the Penn Central could be successfully reorganized if (a) the passenger service was handled in accordance with the principles

of the National Railway Passenger Service Act of 1970; (b) the freight service plant was rationalized; (c) changes were made in the regulation of freight rates; and (d) employment and labor policies were significantly modified. If such "rational terms" were provided, Penn Central could be viable; to the extent they were not, provision must "be made for some different form of compensation for any extra costs incurred for reasons beyond the control of those responsible for the enterprise." The report did not indicate just how, as a practical matter, this largely unprecendented and halcyon solution was to be achieved.[13] Further reports were made in March and September 1971; in the latter the Trustees professed satisfaction "with the time schedule of the reorganization effort thus far," noting they had not yet completed their projections of future traffic levels, which studies were necessary to assess the railroad's viability, asking six more months to test "whether a rational labor pattern can be established," and reporting "substantial progress" in alleviating deficits from passenger service and the launching of an "active abandonment program."[14]

The Trustees made a more comprehensive report on February 15, 1972. They announced that in their judgment "Penn Central *can be* successfully reorganized." (Emphasis in original). They conditioned this prophecy, however, on the attainment of certain forecasts of traffic volume and freight revenues and "the accomplishment of three basic changes in the Penn Central situation which will require action beyond the sole competence of the management, the Trustees, or this Court: rationalization of the Penn Central plant, removal of unnecessary labor costs, and full compensation for continuing passenger service losses." They stressed the importance of consummating a plan before continued operations "so erode the Debtor's estate as to be either practically or constitutionally impermissible." They concluded by saying:

> It should be possible for Federal, state and local governments and all interested parties to analyze the situation as

> presented in this Report and to come to conclusions as to whether they are prepared to cooperate in achieving the changes necessary to allow the Penn Central to continue as a private enterprise. If an adequate response should not be forthcoming, the Trustees will be prepared to advise the Court that this reorganization proceeding is producing a result for which Section 77 was not intended and could not constitutionally have been intended. We do not expect that default.[15]

The Chairman of the Interstate Commerce Commission wrote the reorganization judge that the report constituted

> in effect, clear notice to the public that the Penn Central cannot be reorganized successfully in the manner normally contemplated by section 77 of the Bankruptcy Act. What the trustees are telling us, in short, is that assistance must be forthcoming from the National government, from State and local governments, from shippers and receivers of freight, from passengers, from railroad employees, and from all others who will benefit by continued Penn Central operation if the railroad is to survive. We agree, and we commend the trustees for their candor and for their realistic approach.

On April 1, 1972, the Trustees filed a plan of reorganization expected to become realizable in 1976. This plan proceeded on the assumption that PC's earned income available for fixed charges would reach $275 million by 1976, failing which the plan would be withdrawn. On the effective date of the plan, PC was to be authorized to abandon any uneconomic lines whose operating losses had not by then been covered through contractual arrangement or a subsidy policy, and to terminate any passenger service for which it was not fully compensated; in addition, the plan noted the importance of meeting the railroad's projected increase in freight revenues and in reducing labor expenses. The Trustees

defended their proposed abandonment program against the complaints of some creditors by noting that 11,000 miles of track had been identified as the "freight core" of a reorganized system; these lines had generated 80 percent of the PC's freight operating revenues in 1970, although studies of the projected operating results of such a cutdown system for 1972-1976 were expected to take until September 1972. Noting the New Haven Trustee's criticism of the reorganization plan, that

> [e]ven if an income plan could be devised which carried the hope of some interim success by 1976, the adverse characteristics of the Penn Central system service area . . . flash all the signs of the New Haven's own prior experience. The New Haven was "successfully" reorganized in 1947 after a proceeding which began in 1938, only to become bankrupt again in 1961.

the Trustees replied that they believed that

> given reasonable time and help from others . . . viability will be established, and Penn Central will emerge as a strong carrier with sufficient earning power to operate with confidence in the future.

On October 1, 1972, the Trustees reported that their studies indicated that a 15,000 mile freight core system could produce $243 million income available for fixed charges in 1976, assuming the usual four requisites were substantially attained; this larger system seemed more profitable than an 11,000 mile system because of labor expenses which could be only gradually reduced. The Trustees also discussed possible alternatives to a conventional private income-based reorganization, including public assistance to supply operating costs or capital needs, but noted that this discussion was "not a position of pessimism but one of prudence so that the Court, the public and all interested parties may begin to consider the alternatives."

Appendix C

The Trustees' Interim Reports of January 1 and February 1, 1973 struck a new note. In addition to the three types of outside assistance outlined in the report of February 15, 1972, the Trustees now considered that the Penn Central would require government aid in the range of $600-$800 million. This need was due to two principal factors — delays in realizing some of the goals set in the Trustees' earlier reports, with consequent increase in priority claims, and realization that attainment of the traffic and revenue projections required larger expenditures for modernization of plant. The February 1 report again took note of the large savings that would result from changing the existing 20,000 mile railroad (with gradual abandonments down to 15,000 miles) to an 11,000 mile railroad,[16] and acknowledged that "[s]trong arguments can and will be made that immediate action to relieve Penn Central of the foregoing excessive service and labor obligations is the best course to follow." The Trustees rejected these arguments as impractical, instead looking to the projected but wholly unpromised government aid.[17]

In early February 1973 the Trustees, having exhausted procedures under the Railway Labor Act, made a reduction in the size of train crew consists. This resulted in a strike of operating employees on February 8. Congress stepped in with a Joint Resolution, P.L. 93-5, 87 Stat. 5, approved February 9, 1973. Taking note of the Trustees' views that "a massive infusion of Federal financial assistance would be needed" in any event and that cessation of PC's operations even for a short period "may make it financially impossible to resume operations," Congress imposed a three-month freeze on the implementation of crew consist changes and directed the Secretary of Transportation to submit, within the short period of 45 days, a report which "provides a full and comprehensive plan for the preservation of essential rail transportation services in the Northeast section of the Nation. . . ."

These developments led the reorganization court to issue a Memorandum and Order on March 6, 1973, *In re Penn Central*

Transportation Company, 355 F. Supp. 1343 (E.D. Pa. 1973), "charting a future course for the reorganization proceeding which will be consistent with legal and constitutional requirements." Dealing with the question of erosion, the court said, *id.* at 1344,

> the record justifies the conclusion that post-reorganization deferrals and unpaid administration claims have already eroded the Debtor's estate to the extent of about $500 million. . . . Under any view of the matter, it seems clear that the point of unconstitutionality is fast approaching, if it has not already arrived.

Judge Fullam concluded, *id.* at 1346,

> I take judicial notice of the fact that the legislative and executive branches are now addressing themselves to these problems. . . . It would obviously be premature, therefore, for this Court to make final determinations as to the future course of this reorganization proceeding on the basis of the existing legislative and regulatory framework. The legal and constitutional rights of the parties to this reorganization should be evaluated in the light of whatever changes Congress sees fit to enact.
>
> By the same token, however, this Court cannot ignore the realities of the Debtor's situation. On the basis of the record to date, it appears highly doubtful that the Debtor could properly be permitted to continue to operate on its present basis beyond October 1, 1973.
>
> Under the circumstances, I have concluded . . . that a further hearing should be held on July 2, 1973, to permit a careful and realistic re-evaluation of the situation in the light of intervening events. At that hearing, the Trustees will be required to file either a feasible plan for reorganization of the Debtor, or their proposals for liquidation or other disposition of the enterprise.

Appendix C

Under the legislative prod of the Joint Resolution of February 9 and the judicial prod of Judge Fullam's opinion of March 6, 1973, Secretary of Transportation Brinegar submitted his report to Congress on March 26, 1973. It was a remarkable document, containing the gist of what was to become the Rail Act some nine months thereafter. The report proposed sweeping legislative reforms that would permit identification of necessary core rail services in the Northeast, streamlined procedures for abandonment of unnecessary lines, and formation of a new corporation to operate the redesigned system. The report stressed that "the time for action is short," calling attention to the hearing set by Judge Fullam for July 2 "to hear proposals either for a workable plan or the trustee's blueprint for liquidation," which would be "the Court's only legal recourse" if no plan was forthcoming. On the other hand, the Secretary thought that if Congress "acts expeditiously along the lines outlined in this report, we believe that the Court will have an alternative to liquidation that is better for all concerned and for the Nation as a whole." The Secretary promised promptly to submit proposed legislation.[18]

Congress speedily initiated hearings to consider proposals made by the Secretary and others. On June 21, 1973, Senator Magnuson, Chairman of the Senate Commerce Committee, Senator Hartke, Chairman of the Sub-committee on Surface Transportation, and Representative Staggers, Chairman of the House Interstate and Foreign Commerce Committee, joined in a letter advising Judge Fullam that the appropriate Congressional committees had "begun consideration of a number of legislative proposals which would, if enacted into law, provide relief to the railroads in bankruptcy proceedings in the Northeast" including "varying degrees of federal assistance in solving the crisis which now exists." The legislators expected action by Congress "sometime this summer or early fall."

On July 2, no legislation having been adopted, the PC Trustees requested authority from the reorganization court to submit to the ICC what was called a plan of reorganization. Under the

plan, if aid from the federal or local governments or other sources to compensate for continued erosion was not forthcoming by October 1, all freight and passenger service was to cease on a schedule estimated at 10 weeks. The Trustees would temporarily preserve all assets which might be required if provision for continued rail services were to be made. During the first six months after approval of the plan, the Trustees would consider only those offers to purchase or lease rail properties that committed the offeror to continue or resume rail service; acceptance of any such offer was subject to approval by the court and the ICC.[19] After the end of the six-month period, rail assets for which no such offers had been made or for which such offers had been disapproved, would be scrapped and underlying real estate sold or otherwise disposed of, "unless the Court shall find that a particular sale can reasonably be expected to impair the ability of the Commission to approve the Completed Plan of Reorganization for the Debtors." The Trustees might dispose of non-rail assets at any time, subject to the same condition. Thereafter, on a date nine months from approval of the plan,

> the Trustees and the Debtors shall be relieved of all common carrier obligations in respect of all rail lines and operations of the Debtors, any state law or regulation to the contrary notwithstanding, including operations over all lines of railroad leased from corporations whether or not 50 percent of the voting stock is controlled directly or indirectly by the Debtors.

The liquidation was subject to a proviso, noted above, that,

> If the Court shall, prior to October 1, 1973, have approved arrangements pursuant to which relief is forthcoming from the United States, other government authorities, or other sources to stop the erosion of the Debtors' estates, Penn Central shall continue to provide rail services in the

manner approved by the Court for a period not to exceed 12 months from the date of such approval.

Overruling objections of stockholder interests and others which sought a 90-day extension of referral of the plan to the ICC in view of the pending legislative consideration, the court authorized submission of the Trustees' plan, and requested the ICC "to certify an approved plan of reorganization, or a preliminary step thereof" not later than October 1, 1973. *In re Penn Central Transportation Company*, 363 F. Supp. 1263, 1267 (E.D. Pa. 1973).[20]

On September 28, 1973, the ICC filed its report rejecting the Trustees' and other plans. *Penn Central Transportation Company Reorganization*, 347 I.C.C. 45. A principal ground, probably erroneous,[21] was that a plan which provided for the sale of rail properties without assuring continued rail service was not cognizable under § 77. *Id.* at 79-85. On the other hand, the Commission was correct in pointing out that rejection of the plans left the court free to dismiss the reorganization proceeding pursuant to § 77(g). *Id.* at 85.

At a hearing before the reorganization court on October 12, the Interstate Commerce Commission, the Under Secretary of Transportation and, in a later submission, the Department of Justice urged that, in view of the progress being made in Congress to develop new legislation, the court should not dismiss the reorganization proceedings, as the New Haven Trustee had requested,[22] but should fix a date for a later hearing. Although expressing some impatience at the delay, Judge Fullam deferred action on the proposals to dismiss the proceedings "pending action by Congress on the Rail Act." *See In re Penn Central Transportation Company*, 382 F. Supp. 856, 861 (E.D. Pa. 1974). The latter became law on January 2, 1974.[23]

The scheme of the Act is described in detail in our opinion on the 180-Day Appeals, 384 F. Supp. at 904-10, and there is no need to repeat that here. It suffices at this point to say that the

Rail Act required that the United States Railway Association (USRA) submit to Congress within 450 days a final system plan (FSP) providing for the conveyance to the Consolidated Rail Corporation (ConRail) or to solvent railroads of designated rail properties of those bankrupt estates which were not reorganizable on an income basis; that the FSP should be deemed approved by Congress unless within 60 calendar days of continuous session after submission, either house of Congress passed a resolution of disfavor (in which event USRA was to submit a revised plan to which similar procedures would apply); and that conveyances should take place within 110 days after the FSP became effective. This expeditious program was altered in only two significant respects. Because of delay by President Nixon in appointing the board of USRA, Congress extended the date for the submission of the FSP from 450 to 570 days, 88 Stat. 1464. The FSP, a most impressive document on any view, was submitted on July 26, 1975. Neither house of Congress exercised a veto, and the FSP became effective on November 9, 1975. Meanwhile it had become apparent that the Rail Act required amendment in many particulars. Congress embodied these amendments in Title VI of the Railroad Revitalization and Regulatory Reform Act of 1976, 90 Stat. 31. This approved the FSP as modified by USRA's supplemental report dated September 18, 1975 and the official errata supplement dated December 1, 1975; permitted certain further designations to be made within 20 days; and fixed March 12, 1976 as the date for delivery by USRA to this court of a certified copy of the FSP with a resulting conveyance date of April 1.[24] The conveyances were made effective as of 12:01 a.m. on April 1, 1976; concededly any erosion of the conveyed properties ended at that time.

III. The Authorities

The recent recognition of the continued vitality of *Brooks-Scanlon* and its two companion cases, to which we have referred,

should not obscure how limited those holdings were. The sole issue was the right of a railroad conceded to be a hopelessly losing one to cease operations rather than be obliged to continue indefinitely. There was no issue whether the railroad must first comply with applicable regulatory procedures before it became constitutionally entitled to stop operating.[25] Still less was there any suggestion that the railroads, or others like them, were entitled to be paid by the respective states for losses suffered between the time when they first manifested a desire to cease operations because of their losses and the date when operations ceased. The decisions simply upheld the claims of the railroads that they were entitled to cease operations as against the claims of state administrative agencies which were insisting on their continuance with attendant penalties for refusal to obey; the evident thought was that the owners' remedy for any wrongful action by administrative bodies lay in the courts.

Neither *Brooks-Scanlon* nor the two later cases raised a question concerning another related factor present in these proceedings — the responsibility of a bankruptcy court to bring a reorganization proceeding to an end if all hope of success has faded. Here the seminal case is Judge Frank's opinion in *In re Third Avenue Transit Corp.* v. *Lehman,* 198 F.2d 703 (2 Cir. 1952). This dealt with an application by the trustees of a local transit company in reorganization under Chapter X of the Bankruptcy Act to compel an indenture trustee to turn over proceeds from the sale of mortgaged assets for use in continuing operations. The court of appeals held that, in deciding to grant the application, the district court had not imposed sufficiently stringent tests of the necessity of obtaining the funds and their unavailability from other sources, and of the likelihood of successful reorganization so that the secured creditors would not suffer harm merely to benefit junior claimants. The court said, 198 F.2d at 707:

> There are strict limits to the extent to which, in reorganization proceedings, the interests of creditors (or of a particular class of creditors) may be sacrificed to the public interest; to exceed those limits is (to say the least) to come dangerously close to the edge of unconstitutional taking of property, a line from which courts should keep away if possible. The reorganization judge should not compel a marked sacrifice of that kind, without first deciding, on substantial evidence, whether the interest of the creditors who would be affected by the sacrifice does not demand that prompt steps be taken to bring about abandonment of the utility's operations, including steps to procure the consent of those public authorities (if any) whose consent to abandonment is required. (Footnote omitted.)

There was no suggestion that the Chapter X trustees could ignore public authorities "whose consent to abandonment was required," still less that anyone was bound to pay for losses incurred while this was being obtained.[28]

The more recent line of cases begins with a statement in *Penn Central Merger and N&W Inclusion Cases*, 389 U.S. 486, 510-11 (1968). The Court there rejected a contention of some New Haven bondholders that, because of the erosion of the property of the New Haven, the Penn Central merger should be permitted to be consummated only if the New Haven were fully protected against further erosion. Mr. Justice Fortas said:

> While the rights of the bondholders are entitled to respect, they do not command Procrustean measures. They certainly do not dictate that rail operations vital to the Nation be jettisoned despite the availability of a feasible alternative. The public interest is not merely a pawn to be sacrificed for the strategic purposes or protection of a class of security holders whose interests may or may not be served by the destructive move.

Appendix C

New Haven Inclusion Cases, 399 U.S. 392 (1970), is the only case prior to the Rail Act in which a claim of entitlement to payment for something resembling unconstitutional erosion was pressed. While both sides rely heavily on this decision, in our view its import for these proceedings is considerably less than asserted by either.

While the Supreme Court denied the claim of the New Haven bondholders that the price to be paid by the Penn Central must include erosion of the New Haven's property for the five years before the valuation date, December 31, 1966, or at least for the two years between that date and actual inclusion, 399 U.S. at 492-93, and some language in the opinion is favorable to the Government parties, the circumstances were quite different than here. The claim was being asserted not against the United States as having compelled continued operations but against a private company. Whoever was responsible for the New Haven's continuing in reorganization for seven years before inclusion in the Penn Central system, it was surely not the components of the Penn Central, which would have been pleased at all stages of the proceeding if the New Haven had simply gone away. Indeed no one had been responsible for the New Haven's continued operation in any blameworthy sense. The reorganization judge, Judge Anderson, had been acutely conscious of his responsibility to prevent a wastage of the assets of the New Haven security holders and had manifested his displeasure at the failure of state governments to be more constructive, *see In re New York, New Haven and Hartford Railroad*, 304 F. Supp. 793, 800-01 (D. Conn. 1969); *New Haven Inclusion Cases*, 399 U.S. at 465 n.72; he later stated that but for the prospects of inclusion of the New Haven in the Penn Central, he would have ordered abandonment applications to be filed in late 1963, 304 F. Supp. at 801. The Trustees of the New Haven and almost everyone concerned with it had seen the Penn Central merger as both a peril and a promise, *see In re New York, New Haven and Hartford Railroad*, 378 F.2d 635, 636 (2 Cir. 1967), a peril because the merger would cause

substantial diversion of traffic from the New Haven to the Penn Central and a promise because § 5(2)(d) of the Interstate Commerce Act empowered the ICC to insist on the New Haven's inclusion as a condition to approving the merger. The prospect of receiving marketable securities of what was widely heralded as a railroad with prospects of high financial success[27] was far more attractive than the uncertainties of liquidation in a region deprived of what had been its major rail carrier. Moreover, as the Supreme Court noted, 399 U.S. at 493, no application to the reorganization court to dismiss the reorganization proceedings and thus permit foreclosure of the mortgage liens was made until April 1967. As the Court said:

> [T]he failure of the bondholders to press for early liquidation of the New Haven meant that their initial application for a dismissal of the reorganization proceedings came just as the objective of salvaging the New Haven appeared possible to achieve. As the reorganization court noted, only two of the several bondholder groups made that initial application; it was not joined by the trustees, nor was it endorsed by other representatives of the bondholders and creditors; and it came just as the Commission was about to certify a feasible plan of reorganization to the court.

Thus, the Supreme Court's approval of the erosion burden placed on the New Haven's estate would not be conclusive in a situation in which it was determined that the railroad or its bondholders had sought early dismissal of the reorganization proceeding or applications for abandonment and their claim for compensation lay against the government rather than an acquiring railroad.

On the other hand, we do not consider the Supreme Court's rejection of the proposal made by the ICC in its Fourth Supplemental Report, 334 I.C.C. 25, 58-60 (1968), that the liquidation value of the New Haven as of December 31, 1966, should be reduced by custodial costs, real estate taxes and discount for a

year, which the Commission assumed would been required to obtain a certificate of abandonment, to be so helpful to the transferors' claims to pre-conveyance CUE as they contend. Indeed, it cuts rather the other way. The Court said of the dispute between the Commission and PC on the one hand and the bondholders on the other, 399 U.S. at 461:

> It does not draw into question the right of the Commission to insist that New Haven obtain permission to abandon its operations: no one here quarrels with the proposition that in the event of a liquidation, New Haven would have been obliged to obtain a certificate from the Commission pursuant to § 1(18) of the Interstate Commerce Act. The parties agree that since a delay occasioned by abandonment proceedings before the Commission, followed by judicial review, inheres in the liquidation process, the Commission may exercise its expertise in gauging the extent and expense of such a delay, and Penn Central need not pay for the consequent diminution in the value of the assets of the debtor.

The Court rejected the proposed adjustment essentially because it amounted to double counting.[28] The Court accepted, 399 U.S. at 463, Judge Anderson's finding that the valuation date, December 31, 1966, represented not the date when he would have authorized the New Haven Trustees to seek a certificate of abandonment but the date when they would have had one, since he would have directed application to be made late in 1963 if the solution of inclusion in the Penn Central, far preferable in the public interest, had not been available. Here there is no showing that anyone before 1973 asked the PC reorganization court to require the Trustees to seek abandonment or sale of the PC,[29] nor was there any point before 1973 when the reorganization judge concluded,

as did Judge Anderson in 1963, that the railroad was not reorganizable on an income basis and that the reorganization proceeding would be continued solely to allow alternative arrangements to be worked out.[30]

Continuing with the authorities, we next encounter *In re Central Railroad of New Jersey*, 485 F.2d 208 (3 Cir. 1973) (en banc), *cert. denied*, 414 U.S. 1131 (1974). Dealing with a railroad that had been in reorganization since 1967 with substantial operating losses in each year, *see* 485 F.2d at 22 n.18 (dissenting opinion) and a continuing erosion of assets estimated at $1 million per month, *id.* at 226, the court put the following question, *id.* at 209:

> May a district judge presiding over a railroad reorganization, pursuant to Section 77 of the Bankruptcy Act, permit the Trustees of the railroad to discontinue a loss-producing service or must he withhold his authorization until the Trustees have applied to federal or state regulatory agencies for permission to terminate the service? (Footnote omitted).

The majority answered that the Trustees must at least apply. "There having been no application made, there can be no showing that delay or frustration would be the inevitable result," 485 F.2d at 213 (footnotes omitted).[31]

In our decision on the 180-Day Appeals, we said that while the *Brooks-Scanlon* doctrine remained unimpaired, it had been qualified in two ways. We described the qualification here pertinent as follows, 384 F. Supp. at 919:

> This is that liquidation cannot commence until public bodies, acting under statutory authority, have had a reasonable opportunity to consider and act upon the proposed abandonment, as § 77(*o*) prescribes with respect to the ICC. This is true even when the Constitution requires that a certificate of abandonment must ultimately issue,

> since such proceedings give other parties, notably public authorities, a final opportunity to come up with plans that may prevent serious injury to the public interest.

Finally, there is the brief discussion in *Regional Rail Reorganization Act Cases*, 419 U.S. at 122-25. The discussion was directed mainly to showing the need for determining the applicability of the Tucker Act. It says only that the processes of the Rail Act, especially the possibility noted in the Government's reply brief in the Supreme Court, that "Congress could, in theory, successively disapprove several proposed final system plans," 419 U.S. at 123, might result in an erosion taking, not that they would.

It scarcely needs to be added that enactment of the RRRRA, which authorizes this court to take account of compensable unconstitutional erosion, carried no implication that Congress thought this had occurred and affirmatively desired us to make a pre-conveyance CUE award. Such thoughts as Congress had, while of course not binding us with respect to constitutional questions, were to the contrary. *See* Senate Conference Rep. No. 595, 94th Cong., 2d Sess. 205 (1976), *as corrected* 122 Cong. Rec. S749 (daily ed., January 28, 1976) (clerical corrections):

> Considering substantial benefits conferred by the Rail Act it seems unlikely that any alleged compensable unconstitutional erosion arising from the operation of the Rail Act will be provable. . . . There is no intention even remotely to imply that there may be merit in a claim for pre-Act erosion, or indeed for any erosion.

IV. WHEN DID CUE BEGIN TO ACCRUE—IN GENERAL AND WITH RESPECT TO THE PENN CENTRAL

The PC Trustees do not dispute that the mere fact that a railroad, even one in reorganization is in a hopelessly losing position does not entitle it to quit operations immediately in the face

of statutes requiring approval of such cessation by federal or state regulatory agencies; they concede there is no "taking" until government has had a reasonable opportunity to make alternative arrangements for the carrying on of such public service as is found to be needed. Their position rather is that government—both federal and state—was placed on notice of the PC's plight as early as the Trustees' report of February 10, 1971; that the period of some 32 months from then until October 1, 1973, was more than a reasonable time for government to develop solutions; and that an erosion taking began on that date. The Government parties answer that the early reports of the PC Trustees were nowhere so foreboding as they now assert; that the Trustees made few proposals sufficiently definite to call for action by an agency of the Government and did not pursue the proposals in appropriate proceedings; that despite all the general talk about need for rationalization of plant the PC Trustees made no applications to the ICC for large-scale abandonments;[32] that no application to dismiss the reorganization proceedings was ever made by them and no such application was made by anyone else until the New Haven Trustee's application of October 9, 1973; that the first clear intimation that the reorganization of PC on an income basis would require infusion of federal funds was not made until January 1, 1973 and not quantified until February 1, 1973; and that even if the events of February and March 1973 were to be taken as starting the clock running for a responsible governmental answer—and they insist that no earlier date could reasonably be found—the federal government acted with speed that was not merely reasonable but remarkable in light of the complexities of the situation, with the result that PC was relieved of its common carrier responsibilities far sooner, and on a much more advantageous basis, than if the Trustees had filed applications for abandonment or sales in the winter of 1973 and ultimately had to endeavor to dispose of PC's rail properties.

Our first observation is the obvious one that a § 77 trustee is as much subject to § 1(18) [now slightly amended as § 1a(1)] of

the Interstate Commerce Act forbidding abandonment of a line of railroad or the operation thereof without approval of the ICC as the railroad itself would have been. *Smith* v. *Hoboken Railroad, W&S Connecting Company,* 328 U.S. 123, 130 (1946). We assume the same is true under most state regulatory statutes. *Cf. Palmer* v. *Massachusetts,* 308 U.S. 79 (1939).

A second observation is that § 1(18) requires Commission approval for a voluntary cessation of all operations which is intended to be permanent and not merely for the tearing up of a line. The statute speaks of abandonment either of "all or any portion of a line of railroad" or "the operation thereof"; if the disjunctive language left any room for doubt that voluntary cessation of all operations on a basis intended to be permanent constitutes an abandonment, *Smith* v. *Hoboken Railroad, W&S Connecting Company, supra,* 328 U.S. at 130, and *Thompson* v. *Texas Mexican Railway,* 328 U.S. 134, 144-45 (1946), would remove it.

A third proposition is that § 1(18) does not cease to be applicable merely because serious erosion of the property of a railroad is taking place. As indicated, the railroads in *Brooks-Scanlon, Bullock,* and *Eastern Texas* had been through all administrative processes that were required. Despite the desperate situation of the New Haven, which had experienced net operating losses for four and a half years before invoking § 77, *see New York, New Haven, and Hartford Railroad Discontinuance of Trains,* 327 I.C.C. 151, 166 (1966), and by 1963 had no prospect for a successful reorganization on the basis of capitalized earnings, *see In re New York, New Haven and Hartford Railroad,* 289 F. Supp. 451, 456 (D. Conn., 1968), Judge Anderson considered that authorization to abandon would have had to be obtained from the Interstate Commerce Commission, *In re New York, New Haven and Hartford Railroad,* 304 F. Supp. at 801;[33] as shown above, the Supreme Court rejected the Commission's proposal to take account of an additional year to obtain such authority not because it thought that this was not needed, but because Judge

Anderson had already taken into account a reasonable period for obtaining it. 399 U.S. at 463. Again, as noted in Section III of this opinion, our own decision on the 180-day Appeals held that the *Brooks-Scanlon* principle had been qualified by requiring compliance with reasonable requirements for administrative approval; perhaps it would have been more accurate to say that the *Brooks-Scanlon* doctrine needed no such qualification since the administrative process had been exhausted in that case and its two early companions. *See also New York, New Haven and Hartford Railroad First Mortgage 4% Bondholders' Committee* v. *United States,* 305 F. Supp. at 1055; *In re Central Railroad of New Jersey,* 485 F.2d at 215. The validity of this third proposition is in no way impaired by decisions, stemming from the *Third Avenue Transit* case, *supra,* 198 F.2d 703, that a reorganization court cannot properly impair liens by such measures as approving the issuance of trustee's or receivers' certificates or authorizing use of the proceeds of sale of mortgaged properties for operations when the prospect of successful reorganization has disappeared, but instead must direct a trustee to apply for abandonment.

Apart from authority we see no basis in principle for holding that application of the abandonment provisions of § 1(18) to a debtor for whom a successful § 77 reorganization is no longer possible constitutes a taking of the portion of the estate eroded during a reasonable period required to obtain the needed abandonment authority in a proceeding which enables the Government to explore and develop alternative solutions. Although there is "no set formula to determine where regulation ends and taking begins," *Goldblatt* v. *Town of Hempstead,* 369 U.S. 590, 594 (1962), *see Pennsylvania Coal Company* v. *Mahon,* 260 U.S. 393, 416 (1922); Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1165, 1249 (1967); Ackerman, Private Property and the Constitution 244 (1977), we have no doubt that requiring even a hopelessly losing railroad to obtain

administrative permission for abandonment falls on the regulatory side. The building and operation of a railroad are not merely an added service to persons already on the scene so that its withdrawal would leave them no worse off than they were before. The railroad attracts more people and more investment on the justified expectation that service will continue. As was eloquently said in *The Minnesota Rate Cases*, 230 U.S. 352, 452 (1913), in a somewhat different context:

> The railroad has long been established; to it have been linked the activities of agriculture, industry and trade. Communities have long been dependent upon its service, and their growth and development have been conditioned upon the facilities it has provided. The uses of property in the communities which it serves are to a large degree determined by it. The values of property along its line largely depend upon its existence. It is an integral part of the communal life.

Those who invest in a railroad in the face of statutes prohibiting abandonment without administrative approval do so with the knowledge that operation cannot cease immediately merely because it has become unprofitable and the investors might be better off if the railroad were liquidated forthwith. To be sure, no matter how profitable it may have been in the past, a railroad cannot be compelled to operate indefinitely at a loss. But Congress may constitutionally require, without thereby engaging in a taking, that operations continue until a certificate of abandonment has been obtained through proceedings conducted by an administrative agency with reasonable promptness.

A fourth proposition is that when Congress has specified a particular procedure, namely, application to the ICC, for obtaining authority to abandon, a railroad or its trustee cannot opt out from the statutory requirement in favor of other procedures which they consider just as good. We therefore reject the

argument that interim reports of the PC Trustees, some more gloomy, some less so, served the office of applications to abandon and started the running of the clock for the Government to make an effective response. An application to abandon all or a large part of the operations of the Penn Central would have constituted sharp notice both to the tribunal designated by Congress to exercise "fostering guardianship and control" over the railroads, *Dayton-Goose Creek Railway* v. *United States*, 263 U.S. 456, 478 (1924), and to Congress itself, altogether different in nature and probable effect from reports of the PC Trustees to the reorganization court even though the reports were fully known to the Interstate Commerce Commission. The Commission is legally bound to act on applications filed with it, not on conditions made known to it, however desirable that might be. It simply will not do to say that the condition of the bankrupt railroads in the Northeast had reached such a pass that the ICC was no longer a factor. Section 1(18) of the Interstate Commerce Act stood in the early 1970's as it had since 1920, and the PC Trustees were not relieved of compliance by their view that the crisis called for action beyond the Commission's powers.[34] We reaffirm the statement in our opinion in the 180-Day Appeals that "even when the Constitution requires that a certificate of abandonment must ultimately issue, . . . such proceedings give other parties, notably public authorities, a final opportunity to come up with plans that may prevent serious injury to the public interest." 384 F. Supp. at 919. Among such "public authorities" is the Government of the Unites States. If the PC Trustees had applied to the Commission for authority to abandon in 1971 or 1972, the Rail Act might have been enacted and the conveyances consummated much sooner. They are not entitled to be treated as if they had done what, for one reason or another,[35] they failed to do.

Passing for the moment the important issue of "cashlessness," we therefore cannot accept the oft-iterated claims of the PC and other trustees that, as they put it, their "*Brooks-Scanlon* rights" had "accrued" by October 1, 1973, and *a fortiori* by January 3,

1974, so that despite the absence of proceedings seeking authority to abandon, any further operations must be deemed to have been for the account of the federal government. The error in this contention is that nothing in *Brooks-Scanlon* or any other decision of the Supreme Court or of this court indicates that a right to cease operations "accrues" to a losing railroad until it has complied with reasonable requirements for obtaining administrative approval of abandonment.

On the other hand, we believe enactment of the Rail Act should be taken as relieving the various trustees from any further obligation to apply for leave to abandon. As we pointed out in our decision on the 180-Day Appeals, 384 F. Supp. at 920-21, § 304(f) [now § 304(h)] prohibited abandonments unless authorized by USRA and "unless no affected State or local or regional transportation authority reasonably opposes such action," a standard which would permit few, if any, abandonments.

Indeed, we think there is justification for placing somewhat earlier the date when the various trustees (other than those of the Erie Lackawanna, *see* Section V(F), *infra*) should be treated *prima facie* as if they had applied for abandonment. The trustees argue with force that the prospect of federal legislation during the last three quarters of 1973 made it idle for them to seek authority to apply for extensive abandonments and for reorganization courts to act on such petitions for leave to cease service as were presented to them, and also had an adverse impact on plans to make other dispositions of the properties. *See New York, New Haven and Hartford Railroad 4% Bondholders' Committee*, 305 F. Supp. at 1055-56.

To be sure, there is some inconsistency in the Trustees' saying on the one hand that Congress had a duty to act with respect to the railroad problem in the Northeast and on the other that its doing this in a careful and responsible way enhanced the liability of the United States for erosion claims. It could hardly be expected that the Rail Act would spring, like Athena, from the

head of Zeus. The adverse effects of the nine months of legislative discussion, surely not an unduly long period for a measure as complex as the Rail Act, can be viewed as simply the price which the security holders of the bankrupt railroads must pay for living in a democratic society.[36]

However, the law does not compel the doing of a futile act and we are convinced that after Congress, on February 9, 1973, called on the Secretary of Transportation promptly to submit a report which "provides a full and comprehensive plan for the preservation of essential rail transportation services in the Northeast section of the nation," it was unrealistic to expect that a reorganization court would have authorized an application for large-scale abandonment — although Judge Fullam's order authorizing the PC Trustees to submit their reorganization plan to the ICC came close to that, or that the Commission would have devoted its resources to the processing of such an application. However, this means only that the PC Trustees and, in the absence of evidence pointing to a contrary conclusion, the trustees of other lines are to be treated as if they had *applied* for abandonment in February 1973 — not as if during 1973 they had been denied permission to abandon or been forced to operate despite such permission.

We are convinced that in the case of the Penn Central it would have been impossible to complete abandonment proceedings before April 1, 1976, even if applications for all of Penn Central's trackage had been filed in February 1973 and the Commission had treated the applications, as it should have, as deserving the highest priority. Here was a railroad of more than 19,000 miles, operating in 14 states and the District of Columbia and having 1972 transportation revenues of $1,825,000,000. In our opinion on the 180-Day Appeals we reviewed the practical obstacles to the swift obtaining of permission for any large-scale abandonments, including those resulting from the need for the Commission's staff to prepare environmental impact statements, and

concluded that "the chance of favorable action by the Commission on any large-scale abandonments within 620 days would have been exceedingly poor." 384 F. Supp. at 922. We now know that the situation would have been far more complex than we had envisioned in 1974 since it appears from the submissions made to us in other phases of this case that the PC Trustees would have sought approval of sales to other railroads and to state transportation authorities,[37] as well as abandonments. Sales to other railroads would have given rise to considerations of competitive effect which, with the best will in the world, would have taken many months of hearings and briefings to explore. We thus are confident that even if an application for permission to abandon had been filed in February 1973, it would have been impossible for the PC Trustees to have obtained authority to dispose — not to speak of actually disposing — of a major portion of the rail properties conveyed on April 1, 1976 prior to that date.[38] The fact that formulation of the Rail Act and elaboration and consummation of the FSP took the time that they did is almost sufficient proof of this. Neither Congress nor USRA was obliged to comply with NEPA or the Administrative Procedure Act, as the Commission would have been. Our concern in the 180-Day Appeals with respect to erosion was not over such a period, but over what then seemed a very real probability that at least one house of Congress would veto the initial version of the FSP, with consequent long delay while a revised plan was being formulated and resubmitted, 384 F. Supp. at 922, 925,[39] and a correspondingly long postponement of the conveyance date. This did not occur.

There is one important but limited caveat to our finding that abandonments of PC properties would not have taken place before April 1, 1976 even if applications had been filed early in 1973 and the Commission had proceeded with all possible diligence. While arguing that in general there was no pre-conveyance CUE, the Government parties suggested that we leave it open to the smaller railroads to attempt a showing that but for

enactment of the Rail Act (to which we add the previous nine months of debate), they would have sought and could have obtained authority to abandon or transfer all their operations prior to the conveyance date and would have done so. Fairness seems to require that this opportunity be open to all transferors — not only to the smaller carriers, discussed in Section V *infra*, but also to the PC Trustees, and not only with respect to the whole of their operations but to truly significant parts.[40] Subject to the comments in Section VI of this opinion, we will allow such showings to be attempted.[41]

We say "attempt" since we agree with the Government parties that in view of the interdependence of the various railroads in the Northeast, the burden of demonstrating the probability of obtaining a final decision on and consummating major abandonments or sales before April 1, 1976, even with an assumed filing date as early as the winter of 1973, will be extremely heavy. In a non-Rail Act world, where the ICC would presumably have been faced with a request for abandonment or sale of thousands of miles of track from the Penn Central, not to speak of similar requests by other transferors, the difficulties in providing expedited settlement for any large number of lines would have been extremely grave. The solution which the ICC would have had to devise to the regional rail crisis would have involved a complex piece of regional planning, and we think it unlikely that the ICC would have tied its hands early in the proceedings by permitting abandonment or sale of major lines even before it knew what shape the surviving system might take. The abandonment application of a single line, even though it was a clearly losing operation, would often have significance for other abandonment applications. For instance, while an abandonment of line *X-Y* by bankrupt railroad *A* might be a clear case if service between *X* and *Y* were assured over bankrupt railroad *B*, the situation would stand different if bankrupt railroad *B* also was seeking abandonment authority. In such a case, the Commission would have had to consider whether one of the roads might be able to operate

profitably if relieved of competition by the other, and also to explore the possibility of obtaining service in other ways, whether through acquisition by another carrier or through sale to or subsidy by government. We thus find it likely that the abandonment or sale proceedings in the hypothetical world without a Rail Act, even if they began with separate applications by the various bankrupt railroads, would have involved a consolidated planning process very much like that engaged in by USRA in formulating the Final System Plan but with more time-consuming hearing requirements.

We thus come to the point we have passed so far. This is the contention of various trustees that but for the Rail Act, with its provisions, §§ 213 and 215, designed to keep the bankrupt carriers financially alive while the FSP was being formulated by USRA, submitted to Congress, and implemented, they would have run out of cash and would have been entitled to cease operations on that ground without federal or state administrative permission. Reliance is placed on footnote 31 to our opinion on the 180-Day Appeals, 384 F. Supp. at 919, saying that we assumed there would be no need to obtain approval of abandonments "if, after all reasonable efforts, a reorganization trustee was faced with an imminent depletion of cash that would make it impossible for him to pay current bills for wages, supplies, interline balances, and similar expenses, and still leave an amount sufficient to permit an orderly liquidation." This assumption rests on the basis that a carrier does not "abandon" what it is simply unable to do. *Zirn* v. *Hanover Bank*, 215 F.2d 63 (2 cir. 1954); *ICC* v. *Chicago, Rock Island and Pacific Railroad*, 501 F.2d 908, 911 (8 Cir. 1974), *cert. denied*, 420 U.S. 972 (1975).

The PC Trustees contend that but for the Rail Act they would have reached this point of "cashlessness" in February 1974. In fact, that did not occur in their case or any other because a combination of the carriers' own resources and $557 million in Government funds provided under §§ 213 and 215 of the Rail

Act[42] prevented any of the estates from reaching the point of cash depletion before the conveyance on April 1, 1976.

While it may seem conceptually difficult to characterize a government grant as giving rise to a claim for just compensation on a taking, the point is more troubling than might appear at first blush since the advances did prevent abandonments that otherwise could lawfully have occurred. The Government parties themselves recognize that the argument cannot be pressed to the extreme that erosion claims could be forever avoided by spooning out enough cash to enable a carrier to pay the most necessitous items such as bills for wages, supplies, interline balances, and installments on equipment obligations, while letting other priority items, notably state and local property taxes, continue to accrue. Their position is limited to what they and we consider the situation here, where generally speaking the conveyance occurred within a reasonable time after the beginning of serious discussion of the Rail Act, as measured by the time that would have properly been consumed if applications for abandonment or sale had then been filed. Under such circumstances we do not think the trustees can insist that they had a constitutional right to avoid government cash advances necessary to keep the railroads alive for such a reasonable time as was necessary to effect a solution that would maintain the essential rail services which the Northeastern railroads had conducted long and, until recent years, profitably. It was not until the winter of 1973 that any of the trustees or reorganization judges sounded the clear notes of warning that led to enactment of the Rail Act; we perceive no taking in Congress' having found means to keep the railroads running for a reasonable period while a solution was being devised, submitted to Congress, and consummated.[43] As previously indicated, we will allow a transferor to attempt to show that, but for the Rail Act and the discussions leading up to it, it should have been able to conclude proceedings for abandonment or sale, and to discontinue operations, prior to April 1, 1976; providing a railroad with sufficient

cash to see it through such a period is not an unconstitutional taking.

While we attach no importance to the fact that §§ 213 and 215 funds were advanced only on application by the trustees, we cannot accept the now prevalent characterization of the Rail Act by the bankrupt estates as something forced by Congress on unwilling victims. In pleading at the 1973 House hearings for government action that would resolve the conflict between the interests of the public and the owners, Jervis Langdon, Jr., a PC Trustee with long railroad experience, noted that "in the absence of such a resolution, we must go down the uncertain path of liquidating an enterprise of unprecedented size and importance."[44] to be sure, Mr. Langdon was advocating a solution in which erosion would be stemmed from the date of enactment of the new statute. But we believe that if a referendum had been taken among the security holders, a large majority would have preferred the solution afforded by the Rail Act—especially as that was improved by the RRRRA in 1976 through the provision of certificates of value carrying the full faith and credit of the United States for any shortfall between the value of ConRail securities and the net liquidation value (taking account of CUE and VOB) of the properties conveyed—to the "uncertain path" of liquidation.[45] We find it unlikely that any responsible railroad interests wanted, or expected, liquidation; such opposition as there was to the Rail Act was founded rather on the hope that, faced with a cessation of operations, particularly by the PC, Congress would do something even better for the railroads. We decline to rule that the Fifth Amendment requires such an essay in brinksmanship.[46]

In sum, subject to the caveat noted above concerning supported showings of "pre-conveyance date" abandonment or sale in a non-Rail Act world, and the reservation with respect to administrative claims noted in the next section of this opinion, we are thus of the view that PC suffered no pre-conveyance CUE.[47]

Appendix C

V. The Cases Other Than Penn Central

In this section of the opinion we shall deal with arguments of the smaller roads, most of which contend that their claims for pre-conveyance CUE are even stronger than Penn Central's.[48]

Before going into specifics, we note that the Government parties, which generally denying the existence of pre-conveyance CUE, have suggested that we might leave two points open for later decision. One, to which we have already referred, is that a railroad might be entitled to pre-conveyance CUE if it could show that but for the Rail Act (a concept we would enlarge to include the effect of the discussions that began in February 1973 leading to its passage), it would have filed for abandonment[49] and should have been able, with the exercise of reasonable diligence by the Government authorities, to procure a decision thereon and carry out the abandonment before April 1, 1976. The other is that pre-conveyance CUE might exist if it should develop, in the language of counsel for the Government parties (Transcript of argument, 124) "that a person who extended credit to the railroad during the time it was subject to the administration of a Reorganization Court may have relied upon the authority of the Court as guaranteeing that its administration claim would be paid in full,"[50] and should ultimately find such reliance to have been unjustified. For reasons indicated in Section IV, we consider the first reservation (also expanded to include sales) to be a necessary one; we shall also leave the second point open as the Government parties suggest, since we may never need to decide it if the ultimate valuation is sufficient to cover such claims.

A. *Central Railroad Company of New Jersey (CNJ)*

Of the debtors involved in these proceedings, only the CNJ had initiated reorganization proceedings before PC, to wit, on March 22, 1967. CNJ was atypical in several respects. It carried a burden of commuter passenger traffic in the northern New Jersey metropolitan area which was huge in comparison with its total

operations; its freight services were almost entirely those of a terminating or originating carrier; and we are told that its divisions with longer-haul carriers moving the traffic from and to the west were unfavorable—particularly the divisions in the Wilkes-Barre—Scranton, Pa., area. As early as November 27, 1970, Manufacturers Hanover Trust Co., Indenture Trustee of CNJ's General Mortgage Bonds, filed a petition requiring parties in interest to show cause why the reorganization proceeding should not be dismissed; the court referred this to the ICC for recommendation as required by § 77(g) of the Bankruptcy Act. No action was ever taken by the Commission but the Indenture Trustee took no proceedings to compel this.

For reasons unnecessary to detail, the Trustee initially appointed for the CNJ resigned; the present Trustee, Mr. Timpany, took office in January 1971. He developed a plan outlined in a letter dated March 6, 1971 to the Administrator of the Federal Railroad Administration, which came to be known as a Blueprint for Survival. This included transformation of the CNJ largely into an originating and terminating road serving the northern New Jersey metropolitan area, elimination of its Pennsylvania operations through transfers to other roads which they largely paralleled, sales or abandonments of other portions of the line, discontinuance of a portion of the lighterage service in New York Harbor, revision of CNJ's passenger service contract with the State of New Jersey so that this would cover all costs rather than merely avoidable costs, and sale of a bridge over Newark Bay to The Port of New York Authority which would reimburse CNJ for additional expense in routing traffic over the lines of other carriers. The letter concluded on an optimistic note and constituted the basis for an application for $10 million in federally guaranteed loans under the Emergency Rail Services Act of 1970.

On March 24, 1971, the Secretary of Transportation issued his findings on the Trustee's application which he determined to grant in the amount of $6 million. As required by § 3(a) of the

1970 Act, the Secretary found that cessation of essential transportation services by the CNJ would endanger the public welfare; that cessation of such services was imminent; that issuance of federally guaranteed trustee certificates was the only practicable means of obtaining funds to meet payroll and other expenses needed to provide such services; that the CNJ "can reasonably be expected to become self-sustaining"; and that the probable value of its assets in the event of liquidation afforded reasonable protection to the United States.

The Trustee's application to the reorganization court for authority to issue the certificates was opposed by bondholders. The reorganization judge, Judge Augelli, granted the petition on March 22, 1971, finding that "with the help of the new money, a successful reorganization is indeed feasible and that such reorganization will be effected within a reasonable time." The bondholders did not appeal.

The substantial complaints of the CNJ Trustee begin at this point. There were delays in obtaining authority for abandonments; indeed the Trustee abandoned the Pennsylvania operations without administrative authorization pursuant to an order of the reorganization court permitting temporary suspension of operations pending ICC decision and cessation of operations if the ICC denied the application[51]—action sustained by a panel of the Third Circuit, 455 F.2d 989 (1972), in a per curiam decision which seems basically inconsistent with the later en banc decision, 485 F.2d 208 (1973), *cert. denied,* 414 U.S. 1131 (1974), refusing to allow abandonment of New Jersey passenger operations without application to the appropriate federal and state commissions.[52] The Commission did not fully grant other applications contemplated by the Blueprint, *see R.D. Timpany, Trustee of the Central Railroad Co. of New Jersey—Abandonment of Operation Between Phillipsburg, N.J. and Hudson, Pa.,* 342 I.C.C. 227 (1972); *Routing via Oak Island Jct., New Jersey,* 341 I.C.C. 129 (1972), some of which were opposed by other roads,[53] but the Trustee did not seek judicial review.[54] The ICC failed to act on

applications filed on July 13, 1972, F.D. No. 27145, and December 13, 1972, F.D. No. 27265, for authority to use the Penn Central's Newark Bay Bridge and to provide for major consolidation in the northern New Jersey metropolitan area; the Commission also suspended tariffs providing for a surcharge designed to increase freight revenues by 20%, I & S Docket No. 8932, and declared agreements with shippers to increase revenues to be illegal, *Contract Service Charges Between New Jersey Points,* I & S Docket No. 8702. The State of New Jersey did not enter into the full cost of service passenger contract for which the Trustee had hoped.

Meanwhile, in May 1972 the Indenture Trustee had moved for an order directing the termination of all CNJ's operations on the ground that continued operations had become unconstitutional. The Reorganization Trustee and a Bondholders' Protective Committee opposed this, pointing to various favorable developments. On December 8, the court refused to take this "drastic step" on what it considered an insufficient record, indicating that it did not think "the constitutional line" as to erosion had then been passed. There was no appeal. Shortly thereafter the court did direct cessation of New Jersey passenger service effective January 21, 1973 in the absence of a new contract with the State, saying that without a full compensation agreement "we will run into an erosion of assets that will result in an unconstitutional taking of the debtor's property." This was the order which, after affirmance by a a panel, was reversed in August 1973 by the Third Circuit in the *en banc* opinion to which we have often referred, 485 F.2d 208.

The Trustee contends that the beginning of Congressional discussion of the Rail Act in early 1973 brought to a halt many promising developments[55] including negotiations for a revised passenger contract with the State of New Jersey which had progressed while operations continued under an interim revised subsidy contract.[56] The Trustee advances as further evidence of the adverse effect of the Rail Act that after Judge Augelli had

ruled that the CNJ could not be reorganized under the Rail Act, the State negotiated a greatly improved subsidy contract, from which it turned back after our reversal of the reorganization court's ruling. Finally the Trustee refers to various proceedings during the early part of 1976 before the reorganization court (now Chief Judge Whipple) with respect to the payment of interline balances and other current claims. These culminated in an opinion and order dated March 31, 1976, which directed payment of interline and certain other priority claims but deferred payment of other pre-conveyance administration expenses until the post-conveyance situation could be assessed. We think it best to defer consideration of this last group of contentions until we have a clearer statement of just what the Trustee claims and what the Government parties respond; it may be that all this is a matter for the reorganization court and the Third Circuit rather than for us.

We do not see how any of this entitles the CNJ to more favorable treatment on the issue of when the period for government action should have begun than what we have recognized to be proper in the case of PC. The CNJ's having entered reorganization more than three years before PC is inconsequential; as late as March 22, 1971, the reorganization court found that the CNJ was reorganizable on an income basis if the Trustee's program was carried out and the creditors took no appeal. While the Indenture Trustee sought to have operations cease in December 1972, the reorganization court found that the Indenture Trustee had failed to show that such cessation was constitutionally required, and no appeal was pursued. The Trustee has made a rather impressive showing that Congress' consideration and enactment of the Rail Act had a particularly negative effect on the CNJ; but we give full weight to that by allowing him to prove, if he can, that but for discussion of the Rail Act he would have initiated proceedings for abandonment or sale in February 1973 and that these should have been concluded and the transaction consummated before April 1, 1976. The other reservation proposed by the Government parties will answer fears expressed by

the Trustee that if we should adopt the valuation theory of the Government parties, which he challenges, the estate may not be able to pay administration expenses.

B. *Reading Company*

A principal basis on which the Trustees of the Reading contend that it has a special entitlement to pre-conveyance CUE is that it was doomed by the Penn Central merger, as a result of which it lost revenues on traffic previously interchanged with the New York Central at Newberry Junction, Pa. and other points. The course taken by the Reading, long a "family line" of the Baltimore & Ohio, in not obtaining inclusion in the B&O-Chessie System at the time of that merger, opposing the Penn Central merger, or, until belatedly, even seeking special protective conditions, has been the subject of previous judicial comment. *See Erie-Lackawanna Railroad* v. *United States,* 279 F. Supp. 316, 330-32 (S.D.N.Y. 1967), *modified and aff'd, Penn Central and N & W Inclusion Cases,* 389 U.S. 486, 519-20 (1968). Despite the losses from the PC merger the Reading did not enter reorganization until November 23, 1971.

In May and June, 1973, the Institutional Investors Reading Group filed a petition and amended petition. The latter asked the court to fix October 5, 1973 as the date by which the Trustees should file either a plan of reorganization for continued rail service or a plan of liquidation,[57] and Januay 4, 1974 as the date on which all rail operation would cease unless a plan of reorganization had been filed before October 5 and the court should have determined before November 2 that reorganization pursuant to the plan was feasible. The Reorganization Trustees opposed this, pointing to such things as prospects for increased "piggyback" and coal carriage on account of the energy crisis, various cost reduction and revenue improvement efforts, as well as the possibility of federal legislative response to the Northeast rail situation. An affidavit of J. R. Greene, Vice President-Finance,

prophesied that available cash would double from $2.6 million on July 31 to $5.0 million on December 31, 1973. He pointed to other favorable prospects, including a shift of freight traffic from the Penn Central line serving the Washington-New York-Boston passenger "corridor" to alternate routes of the B&O and the Reading. He also referred to the legislative proposals then pending before Congress and to the benefits the Reading would derive from them. Hearings were held on August 1 and 2. Alfred W. Hesse, Jr., Vice President-Law, testified to the difficulty in formulating a plan in light of the legislative uncertainties, stating that in his opinion the Reading would be included in the proposed restructuring of the Northeast roads. He added that each of the bills arguably provided for protection of the estates during the period in which cessation of operations was to be forbidden. He thought that in the absence of legislation "about October 1" would be the date when the Trustees would "begin the works" of seeking a cessation of service. Although a recent affidavit of Mr. Hesse states that this would have led to cessation of operations on December 1, 1973, the affidavit does not explain how this could lawfully have been accomplished. Apparently the court took no action on the investors' petition.

In contending that CUE began to accrue on December 1, 1973, if not before, the Reading Trustees, like the PC Trustees and the CNJ Trustee, simply ignore the provisions of § 77(g) that the reorganization judge must obtain a recommendation for the ICC before dismissing a proceeding and of § 1(18) of the Interstate Commerce Act requiring the Commission's approval of abandonment.[58] The utmost the Reading Trustees can derive from the record here presented is that, absent discussion of the Rail Act, it would have become the duty of the reorganization court late in 1973 to direct that steps be taken that would permit a lawful cessation of operations.[59] As against this, in the presentation before Judge Ditter in the proceedings under § 207(b) of the Rail Act, the Reading Trustees forecast negative net railway operating income of only $1.55 million for 1974 and positive net railway

operating income of $3.6 million for 1975. *In the Matter of Reading Company*, 378 F. Supp. 474, 476 (E.D. Pa. 1974). While the judge regarded these figures as "overly optimistic," *id.* at 479, his main reason for finding that the Reading was not reorganizable on an income basis was the competition it would face from ConRail and the disappearance of the projected Mid-Atlantic Railroad Company (MARC) as a realistic probability in light of the Rail Act.[60]

The Reading's case for pre-conveyance CUE is thus weaker than PC's or CNJ's. We see no reason to give it the benefit of the assumption that but for the discussion of the Rail Act, it would have filed for abandonment in February, 1973; the earliest date supported by the record for such a hypothetical filing is October 1973. We leave it open to the Reading Trustees to prove, if they think they can, that a petition for abandonment or sale filed in late 1973 should have been acted upon and the transaction consummated before April 1, 1976.

C. *The Lehigh Valley*

The case of the Lehigh Valley (LV) Trustee is much more appealing. As early as July 24, 1972, the Trustees filed a "General Plan for Reorganization" in which they concluded that reorganization of the LV as then configured on an income basis was impossible and that successful reorganization depended on a consolidation of its facilities with those of the Reading and the CNJ. However, it became apparent as a result of cash shortages that this plan could not be carried out, and on March 13, 1973, the Trustees filed a petition with the reorganization court (Judge Fullam) for leave to cease operations on October 1, 1973 unless the court should find prior to September 1 that an income based reorganization was "probably feasible and can be consummated within a reasonable period of time consistent with the creditors constitutional rights." Like other petitions to which we have referred, this one seems to have assumed that § 1(18) of the

Interstate Commerce Act had no application. A hearing was held in June 1973. Judge Fullam deferred ruling "[i]n view of the imminent prospect of legislation. . . ." *In re Lehigh Valley Railroad*, 382 F. Supp. 842, 844 (E.D. Pa. 1974) (opinion under § 207(b) of the Rail Act).

The LV Trustee is entitled to endeavor to establish that but for the discussion of the Rail Act he should and would have filed for abandonment or sale early in 1973, and to prove that such an application should have been acted upon and the transaction consummated before April 1, 1976.[61]

D. *The Lehigh & Hudson River Railroad*

The Lehigh & Hudson River Railroad (L&HR) is a small bridge carrier[62] operating between points in Pennsylvania where it connected with the PC and LV and Maybrook, N.Y., where it connected with the New Haven. After inclusion of the New Haven in the PC system, the PC diverted much New England traffic formerly handled over the L&HR to its route on the west bank of the Hudson River to Albany and thence over the former New York Central line into New England. Because of this loss of traffic the L&HR filed for reorganization in the Southern District of New York in April 1972.

After having borrowed $200,000 secured by a chattel mortgage on four locomotives,[63] the Trustee, on July 9, 1973, filed a petition with the reorganization court (Judge Ward) for an order directing cessation of operations no later than October 1, 1973, unless a finding should be made by the court prior to September 1, 1973, that "an income based plan of reorganization is probably feasible and can be consummated within a reasonable period of time consistent with the creditors' constitutional rights." The petition indicated doubt as to the Trustee's being able to meet payrolls after October 1. Hearings were held on July 26 and 27. Counsel for the United States neither supported nor opposed the petition; he thought "temporary" cessation of operations might

not require ICC approval and asked only that the track be left in place. The court took no action in light of the probable enactment of the Rail Act.

The L&HR Trustee has made out a case for taking July 31, 1973 as the date by which an application for abandonment or sale would have been made but for the pendency of the Rail Act. Also, in view of the small size of this carrier and the predominately bridge character of its traffic, he may have a better chance than most to show that a reasonable time for action by the ICC would have expired and the transaction would have been consummated before April 1, 1976.

E. *The Ann Arbor Railroad Company*

The Ann Arbor Railroad, a subsidiary of the Detroit, Toledo & Ironton Railroad Company (DT&I), extends in a northwesterly direction from Toledo, Ohio, through Michigan, to Lake Michigan, across which it operated car ferries to terminals on the Wisconsin side of the lake. Two of these car ferry routes had been abandoned, with ICC approval, in 1968, and 1970. On June 19, 1972, the Ann Arbor filed a petition, FD-AB49, for authority to abandon the two remaining car ferry routes, between Frankfort, Michigan, and Manitowoc, Wisconsin, and between Frankfort, Michigan, and Kewaunee, Wisconsin, together with a connection 20.53 mile line of railroad between Thompsonville and Elberta, Michigan, plus a 1.87 mile spur from Elberta to Frankfort. The car ferry operations allegedly caused losses of more than $877,000 in 1970, $1,075,000 in 1971, and $1,330,000 in 1972, based on the ICC's "50-percent" rule used to estimate off-branch costs in ICC abandonment proceedings — a formula alleged to have the result of understating losses under the circumstances here presented. The ICC took no action on the petition because of the "freeze" it had imposed on abandonment applications after the district court decision in *Harlem Valley Transportation Association* v. *Stafford*, 360 F. Supp. 1057 (S.D.N.Y.,

June 21, 1973), that the ICC staff must prepare an EIS where abandonment applications constituted "major Federal actions significantly affecting the quality of the human environment," *see* 42 U.S.C. § 4332(2)(C), during the course of an appeal to the Second Circuit, which affirmed on June 18, 1974, 500 F.2d 328.

By the time the freeze was lifted, *see* 384 F. Supp. at 921-22, Congress had enacted the Rail Act which transferred to USRA authority to permit abandonments of carriers being reorganized under the Rail Act but forbade the granting of permission to abandon if this was reasonably opposed by any affected State or local or regional transportation authority, § 304(f) [now § 304(h)]; both Michigan and Wisconsin opposed abandonment of the two car ferries. Meanwhile the Ann Arbor had filed on October 15, 1973 for reorganization under § 77 in the Eastern District of Michigan. We are told that although it had been hoped that if the Ann Arbor were shorn of its car ferry operation, it might show a profit, these hopes faded as 1973 progressed, and the reorganization court (Judge Pratt) found on July 1, 1974 with the assent of all parties that the Ann Arbor was not reorganizable on an income basis and should be reorganized under the Rail Act.

The Ann Arbor may well be entitled to pre-conveyance CUE with respect to erosion from operating the car ferries and the related mileage sought to be abandoned. The application, which made a strong showing of an unconstitutional deprivation, had been on file for a year and a half when the Rail Act was enacted; apparently the Ann Arbor was a victim of the ICC's action in unilaterally declaring a moratorium on the disposition of abandonment applications while the *Harlem River* litigation was in progress, or of the consideration of the Rail Act, or of both. The rest of the line stands differently. Here there is nothing to indicate that but for discussion of the Rail Act the Trustee would have sought abandonment as early as February 1973; apparently this might have been done sometime in the spring of 1974.

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F. *Erie Lackawanna Railway Company*

The Erie Lackawanna Railway (EL) filed for reorganization under § 77 in the Northern District of Ohio on June 26, 1972. However, in proceedings during the spring of 1974, the reorganization court (Judge Krupansky) found in its Order No. 234 that EL was reorganizable on an income basis. Subsequent developments are recorded in our opinion of April 11, 1975, as follows, 404 F. Supp. 954, 955-56:

> As a result of adverse economic developments unforeseen when the order (Order No. 234) was entered, EL failed to realize the results projected for 1974. On January 9, 1975, the EL Trustees announced their changed conclusion that EL was not reorganizable on an income basis under § 77 within a reasonable time and their intention to seek an amendment of RRRA that would permit EL to be brought under that Act, as it might initially have been. Less than a month later a number of EL's Indenture Trustees filed a petition in the district court for an order dismissing the § 77 proceeding in favor of an immediate equity receivership and fixing a date for cessation of operations. About the same time the EL Trustees filed a petition for authority to cease operations because of prospective lack of sufficient cash to meet payrolls and other bills; this petition was later withdrawn in light of the prospect of enactment of the amendatory legislation that would enable EL to be placed under RRRA, which the EL Trustees were seeking. The Trustees announced that if the amendment was adopted they would petition for reconsideration of Order No. 234; the Indenture Trustees sought unsuccessfully to enjoin this. On February 27, 1975, the district court began a hearing to consider the various matters that had been brought to its attention.

The amendment became law on the following day, 89 Stat. 7 (1975). The Trustees, on March 3, 1975, filed a petition asking the reorganization court to reconsider Order No. 234 and determine that reorganization should proceed under the Rail Act; they also petitioned for authority to enter into arrangements for emergency financial assistance under § 213. The court granted both petitions, and we affirmed its decision on the former. The EL Trustees sought and received emergency assistance under §§ 213 and 215.[64]

Although the EL Trustees make more extreme claims, the main thrust of their position is and has to be that CUE began to accrue in January 1975 when they became aware of the seriously adverse change in their prospects of successful reorganization and the prospective exhaustion of cash. What we have said in regard to the case of the PC Trustees applies with still greater force to the EL Trustees. EL's decision to bring itself under the Rail Act simply started the clock running, and the conveyance date came less than 15 months after the EL Trustees made their plight known and secured the amendment of the Rail Act needed to allow EL to come under it.[65] We have already given our answer to the argument that but for the Rail Act the EL Trustees would have been freed from any requirement of securing § 1(18) approval by sheer impossibility; we do not think any CUE rights accrue if Congress provides the wherewithal to keep even such a railroad alive for what would have been no more than a reasonable period for the ICC's acting upon an abandonment application. In sum, unless the EL Trustees can show there were substantial pieces of their line for which but for the Rail Act petitions for abandonment or sale would have been filed in March 1975 and should have been acted upon so as to permit consummation before April 1, 1976, a showing we would think almost hopeless, they are not entitled to pre-conveyance CUE.

VI. Conclusion

We should not end this opinion without reference to a basic theme running through the briefs of almost all the trustees and investor interests which we have not discussed in express terms. This is that after a certain date, claimed (except in the case of the EL) to be certainly no later than January 2, 1974 and generally before, the bankrupt railroads were operated solely in the public interest and the Constitution, as construed in *Brooks-Scanlon* and other cases, requires the public to pay for losses incurred during that period.

Our discussion in Section IV was mainly directed to showing that even if the premise were sound, the conclusion would not follow since the Constitution does not require that a losing railroad be permitted to quit immediately even if its continued operations during administrative proceedings conducted with reasonable diligence served no private ends. We think also that the premise is highly questionable. With deep respect for the sincerity of counsel, we believe their concentration on maximizing claims for pre-conveyance CUE has produced a certain amount of myopia as to the parlous condition of these railroads in 1973. As we said in our opinion on the 180-Day Appeals, 384 F. Supp. at 917:

> [T]here is a certain incongruity between the high demands which the investors make of the Act and the unhappy position they, or in any event most of them, occupied when it was enacted. The idea that billions of dollars of liquidation proceeds of these bankrupt railroads are lurking just around the corner is unrealistic in the last degree.

The prospect of having to liquidate these bankrupt estates in a region largely deprived of railroad service was scarcely enticing. The various trustees answer that this would not have happened, that if the respective reorganization courts had issued orders

permitting a shutdown when cash available for operations had sunk to the level described in fn. 31 of our opinion on the 180-Day Appeals, 384 F. Supp. at 919, as they could lawfully have done, Congress would have stepped in with something—either outright condemnation or, alternatively, an interim take-over of the use of the roads with the Government shouldering all losses until a solution like the FSP could be devised and consummated. These, of course, are possibilities,[66] but no one in the dark days of 1973 could have been sure that either would materialize or what form they would take if they did. The Rail Act itself and the committee reports accompanying the House and Senate bills[67] afford evidence that Congress was not prepared to go so far so fast. The more likely response to imminent cessation because of cashlessness would been the provision of further emergency assistance. Moreover, the possibility or even a probability that the federal government, had it been faced with an imminent shut-down, might have come up with something more favorable to the railroads than the Rail Act in erosion terms does not mean that erosion borne by the roads under the chosen solution constitutes a "taking"; the mere fact that the government chooses one alternative over another does not make it liable for the greater benefits the railroads would have realized from a choice it rejected or never had to consider.

As previously indicated, we are confident that, *non constat* the position of various indenture trustees who had to be conscious of their fiduciary responsibilities, if a referendum had been taken a vast majority of the security holders would have favored continuing operations through 1973 in the hope of passage of the Rail Act or something like it and thereafter for a reasonable time for formulating and consummating the FSP. In our view therefore, operations were continued up to and beyond the point of the railroads' own "cashlessness" not solely to serve the public interest, nor solely to serve the private interest of the estates, but to serve both.

These and other considerations we have canvassed might seem to lead to a complete refusal to recognize pre-conveyance CUE. Yet even the Government parties do not urge us to go quite that far. At argument, although not explicitly in brief, they were willing to leave open for further consideration the case of the small railroad that might have been able to secure abandonment authority and to have discontinued operation but for the Rail Act before April 1, 1976, and the case where administration claims exceed the value of the bankrupt estates. We have gone somewhat beyond the former concession and have held that CUE would begin to accrue on a date when the Interstate Commerce Commission should have granted an application for abandonment or sale which would have been filed if the Rail Act and the debate over its passage had not rendered this futile and operation had been discontinued as a result.[68] We realize that this solution will not be truly satisfactory to anyone, especially to the various trustees and the estates they represent, although both they and the Government parties should take account of our correlative holding that, to the extent that the Government has used its "reasonable time to secure abandonment or sale permission" argument to postpone the accrual of CUE, it cannot use the same period a second time to reduce the value of the properties conveyed on April 1, 1976 in any discounting required to reflect the need of securing regulatory approval for dispositions in a non-Rail Act world.

Parties on both sides have noted that in contrast to the almost total disagreement on when CUE commenced to accrue, there is a considerable measure of agreement with respect to the elements entitled to recognition as its components. Now that we have prescribed guidelines with respect to the accrual of CUE, we do not think it unreasonable to ask the parties to endeavor, in the same spirit of cooperation they have manifested on many matters, to flesh these out by agreement among themselves in terms of precise properties and dates.[69] One thing that has been obvious about these proceedings from the beginning is that no amount of

effort by counsel and the court will produce a mathematically precise figure of what the estates are constitutionally entitled to receive and the Government is required to pay; the best for which anyone can hope is a fair approximation. We realize that the amounts here at stake are large; that the Government parties may be fearful that any agreement, even on the limited points here suggested, would be criticized by members of Congress or the media as too favorable to the railroads; and that the trustees may be equally fearful of claims that they have not fully discharged their fiduciary responsibilities. But it has now become apparent that agreement on some points will be vital if this court is to meet what we once thought to be the unduly pessimistic five to ten year timetable forecast by Representative (now Secretary of Transportation) Brock Adams, *see* 119 Cong. Rec. 36355 (Nov. 8, 1973); 384 F. Supp. at 926. If this court can assist by elaboration of this opinion or otherwise, it stands ready to do so.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

April 19, 1977

Appendix C

FOOTNOTES

1. As noted in our opinion of October 18, 1976, 425 F.Supp. 266, 269-70, we shall treat the "fair and equitable" language of § 303(c) as equivalent to the standard of "constitutional minimum", unless in the valuation proceedings there should be a specific and supported claim that the standards differ in result.

2. *See also* the last sentence of § 303(c)(3).

3. *See also* Senate Conference Report No. 595, 94th Cong., 2d Sess. 205 (1976), *as corrected* 122 Cong. Rec. S749 (daily ed., Jan. 28, 1976):

> The base value of the certificates is to be increased by whatever amount, if any, of compensable unconstitutional erosion the special court finds to have occurred in the estate of the railroad transferor of rail properties holding the particular series of certificates during the period of the bankruptcy proceeding of such estate.

4. In our 1974 opinion, we concluded that we could direct compensation for unconstitutional erosion in any of the properties owned by the estate of a railroad under the Act, whether or not the properties were conveyed, so long as the railroad was the transferor of some properties; we noted, however, that our ability to assure full compensation was limited, especially if the transferors' principal valuation claims should be sustained, 384 F. Supp. at 925-26 & n.51, leaving suit in the Court of Claims under the Tucker Act as the only alternative for any transferor whose claims were thus not satisfied. The current Act makes explicit our ability and obligation to take into account compensable unconstitutional erosion in determining the base value of the certificates of value which are issued to every railroad that has transferred some properties to ConRail. The unrestricted language of § 306(c)(4) and the interest expressed by the 1976 Conference Committees of the House and Senate in promoting judicial economy, *see infra*, indicates we should include in the base value of the CV's all compensable unconstitutional erosion suffered by a transferor to ConRail, whether in the properties transferred to ConRail or to a profitable railroad or in properties not transferred at all. However, as the PC Trustees note, any post-conveyance erosion damages which accrue after this court's final decision on valuation still would have to be left to the Court of Claims for remedy.

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The House and Senate Conference Committees commented on the erosion provisions as follows:

> For reasons of judicial economy, if for no other reasons, it is desirable that the court that is rapidly acquiring vast knowledge of the regional rail reorganization problem take into account the so-called erosion claims in its section 303(c) determinations. There is no intention even remotely to imply that there may be merit in a claim for pre-Act erosion, or indeed for any erosion. However, we are interested in simplifying the litigation, and take note of the fact that there is now pending in the Court of Claims an action alleging both pre-Act and post-Act erosion. In line with the same goal, it is our intention that all actions for unconstitutional erosion now pending or subsequently filed in the Court of Claims be stayed until the Special Court has ordered the distribution of the securities and the certificates of value pursuant to section 303(c)(4) of this Act.

S. Rep. No. 520, 94th Cong., 2d Sess. 205 (1976), *as corrected* 122 Cong. Rec. S749 (daily ed., Jan. 28, 1976) (clerical corrections).

5. We added that "a relatively early resolution of these issues [was] essential in order to enable us to direct what studies should be prepared, since USRA contends that there has been no CUE."

6. At oral argument counsel for the Penn Central (PC) Trustees indicated a belief that we had not set for discussion the issue whether valid erosion claims began on January 2, 1974, the date of enactment of the Rail Act, or any date subsequent to that date and prior to April 1, 1976. We see no basis for such a reading of the June 16 Memorandum, *see* fn. 5. While we singled out claims for erosion prior to January 2, 1974 and subsequent to March 31, 1976, as creating special problems, the memorandum made clear that we wished to deal comprehensively with all relevant legal issues pertaining to CUE. No different conclusion was justified by so much of our opinion of October 18, 1976, 425 F. Supp. at 270-71 as deferred decision whether the Rail Act was a reorganization statute or a condemnation statute or both. In any event the briefs and arguments include all material relevent to our making a determination whether CUE begins to accrue on January 2, 1974, or at some date between then and March 31, 1976, if it had not previously begun to accrue, and the brief of the PC Trustees itself argues, p. 113 n.1:

> If, contrary to our contentions, it should be determined that Penn Central did not reach the point of erosion taking prior to the passage of the Rail Act, then it would be our contention that passage of the Act itself accomplished such a taking by subjecting Penn Central to a further period of compelled operations beyond the point of unreorganizability.

Also we have had the benefit of reading the full presentation in the brief of the PC Trustees filed January 6, 1977, to the effect that CUE began to accrue on January 2, 1974, if it had not done so before.

7. *See Pennsylvania* v. *ICC*, 535 F.2d 91, 97-98 & n.13 (D.C. cir. 1976), *cert. denied*, 45 U.S.L.W. 3251 (U.S. October 4, 1976), suggesting that this was a matter for the Court of Claims.

8. In addition, we do not pass at this time on the claim, advanced only by the Erie Lackawanna (EL) Trustees, for any income tax liability that may, despite P.L. 94-253 (March 31, 1976), 90 Stat. 295, accrue on an award for CUE.

9. There is general recognition by the parties that determination of the amount of some elements of physical erosion, notably deterioration of plant that has been conveyed, will depend on the theory of valuation. Such deterioration would be of much greater importance if a property were to be valued on the bases of sale for continued rail use than if it were to be valued on the basis of a sale for scrap. Because of these and other considerations, this opinion will not discuss the elements of erosion but will be devoted solely to the issue of the date when erosion claims accrued.

10. The railroads in *Brooks-Scanlon* and *Eastern-Texas* had engaged in interstate commerce, but the *Brooks-Scanlon* case was decided before the Transportation Act of 1920 adding § 1(18) was passed, and the Interstate Commerce Commission had authorized abandonment of interstate operation by the Eastern Texas, *see Texas* v. *Eastern Texas R.R.*, 258 U.S. 204 (1922).

11. One of them, the Eastern Texas Railroad, was wholly without cash or credit and could not operate at all. *See* 264 U.S. at 83. The same may have been true of the railroad in the *Bullock* case, *see* 254 U.S. at 519.

12. Although some transferors quote Justice Holmes' earlier statement, 251 U.S. at 399:

> A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage.

It is clear that the portion of the sentence preceding the comma is not the law. *See Fort Smith Light & Traction Co.* v. *Bourland*, 267 U.S. 330 (1925) (Mr. Justice Brandeis writing for a unanimous Court). *Cf. Baltimore & Ohio R.R.* v. *United States*, 345 U.S. 146 (1953).

13. Efforts in the earlier New Haven and Central of New Jersey reorganization proceedings, which might have served as precedent, had been largely aimed at having state or local government bodies assume the burden of commuter passenger service and grant tax relief. The federal government undertook the provision of intercity passenger operations by the National Railroad Passenger Service Act of 1970, 84 Stat. 1327 (1970). There has been a continuing controversy between the PC Trustees and the National Railroad Passenger Corporation (Amtrak) concerning the adequacy of payments by the latter.

Certain of the changes proposed by Penn Central in February 1971 were beyond the complete control of either the federal or state and local governments. For instance, the PC Trustees complained of the "merger guarantee payments" received by PC employees, conditions to which the Pennsylvania and New York Central Railroads had themselves agreed to effect the merger under conditions of labor peace. Similarly, the PC's proposal for a joint labor-management committee to review work rules was addressed to the transportation unions, not the government.

Other changes would have required governmental action, for instance the proposal that "below cost" freight rates be prohibited by legislation, or that the ICC separate rate increases for line haul services and terminal services, but the report does not detail whether the PC had actually proposed draft legislation for the former, or had made application to the ICC for the latter. The PC's proposal for "rationalizing" freight plant—apparently that any losing branch of a railroad should be required to stay in operation, even during abandonment proceedings, only if the branch operating losses were compensated—might be faulted in the case of a profitable railroad for ignoring the constitutional logic of *Fort Smith Light & Traction Company* v. *Bourland, supra*, 267 U.S. 330; again, there is no indication that the PC Trustees had actually put forward draft legislation for such subsidization.

14. The September 1971 report noted that the Trustees' own studies to determine which lines should be abandoned would take at least three

years to complete, although earlier conclusions could be drawn as to 1900 miles of possible abandonments and 5200 miles of track which clearly would be retained; in addition the reorganization court had already approved the preliminary filing of abandonment applications for 1928.4 miles of track with the ICC.

15. The report noted some progress in the PC's efforts to rationalize its operations, including an agreement with the transportation unions implementing work rule changes, and the repeal of New York's and substantial modification of Indiana's full-crew law.

16. It was estimated, for example, that whereas in 1973 the existing railroad would have a deficit of $157.2 million in net railway operating income, an 11,000 mile railroad — if all employees unnecessary to the operation of such a smaller road (except for excess trainmen on crews to be retained) were let go without cost — would have had net railway operating income of $59.0 million.

17. One reason was that "labor would expect large labor protection payments, amounting to $774.1 million through 1976 alone, if Penn Central were free promptly to move to a railroad of 11,000 miles."

18. On the same date the ICC submitted a report, Ex parte No. 293 (1973).

19. ICC approval was to be obtained through the submission of Transfer Reports. The Plan provided that

> The Commission shall promptly hold hearings on the Transfer Reports to determine whether acceptance of the offers recommended by the Trustees or the approval of any offer recommended for rejection by the Trustees would be consistent with the standards of Section 1(18) of the Interstate Commerce Act, Section 77 of the Bankruptcy Act, and of due process. The Commission's decisions shall be submitted to the Court for approval either on an individual offer basis or in the aggregate.

Nothing was said about § 5(2) of the Interstate Commerce Act.

20. The court noted, however, that

> It should be emphasized at the outset that the Court is not now called upon to adjudicate the merits of any proposed plan of reorganization; indeed, § 77(d) of the Bankruptcy Act makes it clear that this Court lacks power to review any proposed plan

> until it has been considered by the Commission and certified to this Court by the Commission. . . .
>
> * * *
>
> Under the provisions of the Bankruptcy Act, there are, arguably, two approaches to a resolution of the Debtor's precarious financial position. The first of these is by way of a plan of reorganization. Such a plan may or may not ultimately provide for liquidation of all or part of the Debtor's railroad. That issue is not before the Court at this time. . . . The Trustees' proposal merely initiates the proceedings before the Interstate Commerce Commission. The plan which they propose to file expressly provides that, in the event of Congressional action before October 1, their plan would be amended. Thus, the Trustees' plan is sufficiently flexible to cover all possible eventualities.

363 F. Supp. at 1265-66.

21. *See Tennessee Central Ry. Abandonment*, 333 I.C.C. 443 (1968), 334 I.C.C. 235 (1969); *In re Tennessee Ry.*, 304 F. Supp. 789 (M.D. Tenn. 1969). The ICC might rightfully have objected, however, that the PC reorganization plan made no provision for seeking abandonment permission under § 1(18), *see* 347 I.C.C. at 82-85, for the termination of service within 10 weeks if no interim compensation was forthcoming to stem erosion, and for the sale for scrap after 6 months of any of the rail assets for which offers had not been received for continued rail use. Under the existing provisions of the Interstate Commerce Act, there is no indication that such § 1(18) proceedings could have been dispensed with, *see* Bankruptcy Act § 77(*o*); *Tennessee Central Ry. Abandonment*, *supra*, 333 I.C.C. at 444-45.

22. Similar requests were later made by other creditor interests.

23. Subsequently, on May 2, 1974, the PC reorganization court made the finding required under § 207(b) of the Rail Act as to whether the PC was "reorganizable on an income basis within a reasonable time under section 77." *In re Penn Central Transportation Company*, 382 F. Supp. 831 (E.D. Pa. 1974). Though Judge Fullam found that the PC was not so reorganizable, this conclusion was not based on the nature of PC's transportation market as such, but on the PC's cash shortage, its burden of administrative expenses, its need for capital to maintain the quality of freight service, and its presumed inability to reduce the size of

its plant to 15,000 or 11,000 miles with expedition. For such smaller plants, assuming the quality of freight service did not deteriorate, the reorganization court estimated a net railway operating income (before fixed charges) of $39.8 million and $104.9 million, respectively, in 1976, and $102.8 million and $171 million in 1978. *Id.* at 842. Even with its current plant, the court projected that PC would improve its net railway operating income from negative $153.2 million in 1974 to negative $14.0 million in 1978. *Id.* at 840.

24. USRA was authorized to extend the certification date to a date not more than 30 days after March 12, 1976, by notice filed with this court, the Congress, and the reorganization courts not later than February 10, 1976. § 209(c) as amended. USRA did not take advantage of this authorization.

25. In *Brooks-Scanlon* the railroad had ceased operating, initially with permission, but the Louisiana Railroad Commission, after a hearing, had ordered it to resume; Mr. Justice Holmes treated with contempt a suggestion that, despite the full hearing and order by the Commission directing a resumption of operations, the railroad must start a new proceeding with a petition for leave to discontinue which would surely be denied, 251 U.S. at 400. In *Bullock* the railroad had earlier applied to the Florida Railroad Commission for leave to discontinue and had been refused, 254 U.S. at 519. The Eastern Texas had received authority from the Interstate Commerce Commission to abandon its interstate business, *see* fn. 10 *supra*, and the Court found there was no Texas statute requiring it to obtain authority to abandon intrastate operation.

26. In a footnote to the passage quoted above, the court cited *Bankers Trust Company* v. *Gebhart*, 195 F.2d 238 (2 Cir. 1952), in which an indenture trustee of a hopelessly losing railroad sought to prevent a further loss of equity allegedly available for bondholders that would occur through the reorganization trustees' conveying the railroad's equity interest in two locomotives to the RFC in exchange for an extension of maturity on two other classes of equipment trust certificates. The Second Circuit, speaking through Judge Frank, directed the reorganization judge to pass on the indenture trustee's petitions to require the reorganization trustees to apply to the ICC for abandonment before making the conveyance. Again there was no hint that abandonment proceedings could be dispensed with.

27. One of the points in dispute between the New Haven Trustees and Penn Central was the Trustees' demand that a larger portion of the

consideration be paid in stock rather than in debt. *See New Haven Inclusion Cases*, 399 U.S. 392, 483-84 (1970).

28. The Court's reasoning does lead to the conclusion that to the extent the Government parties make use of the delay between enactment of the Rail Act (or any earlier date taken as starting the period for governmental action) and April 1, 1976, to defeat a claim for CUE on the ground that at least that much time would have been consumed in obtaining permission to abandon or sell, that period cannot be taken into account a second time in determining when the proceeds of sales would come into hand. *See* 399 U.S. at 466, quoting with approval Judge Anderson's opinion, 304 F. Supp. at 801.

29. Though the New Haven Trustee opposed the PC's application in early 1971 to issue $100 million in federally guaranteed trustees' certificates under the Emergency Rail Services Act, and disputed the feasibility of the PC Trustees' April 1, 1972 plan of reorganization, *see* text *supra*, he did not move the reorganization court to dismiss the § 77 proceedings until October 9, 1973.

30. Though the Trustees announced in February 1973 that $600-800 million government aid to finance improvements over a period of years was prerequisite to further attempts to effect an income-based reorganization, because of the cash shortages faced by the Penn Central and the urgent need to improve the condition of the railroad plant if freight revenues were to be increased, they also said that with such aid reorganization still seemed feasible. As the Trustees noted on January 1, 1973, "[W]ithout government financial assistance for improvement of the railroad, a reorganization of Penn Central cannot be achieved in 1976 . . . . If this support is forthcoming promptly, the Trustees believe that Penn Central can be successfully reorganized on a private-income basis by 1976," assuming the three other conditions of eliminating unnecessary employees, uneconomic freight lines, and uncompensated passenger service were also attained. On February 1, the Trustees again noted, "The Trustees believe that the plant and equipment investment program described in this Report will result in a viable railroad which can remain in the private sector."

Similarly, as noted in the text, *supra*, Judge Fullam's March 6, 1973 order warning of a possible October dismissal of the reorganization proceeding was expressly left open to reexamination in light of legislative developments, and was apparently based on the increasing size of

PC's erosion burden rather than a conclusion as to PC's ultimate reorganizability. In authorizing the PC Trustees to submit a plan of reorganization to the ICC in July 1973 providing for liquidation of the railroad, the court expressly noted it was not empowered to pass on the merits of the plan until after ICC review, *see* fn. 20 *supra*. In the October 12, 1973 hearing Judge Fullam deferred action on proposals to dismiss the reorganization, pending legislative action.

The PC Trustees argue that at the time of the October 12, 1973 hearing, "the principal legislative draft was a September 27, 1973 subcommittee print of H.R. 9142 (the 'Shoup-Adams bill')," and that under §§ 303(d) and 102(5) of the bill the consideration for the properties was to be "the greater of fair liquidation value or going concern value thereof as of September 30, 1973." The Trustees suggest that if Judge Fullam could have foreseen the design of the Rail Act as enacted, he would have insisted on some protection against further erosion as a price of not dismissing the § 77 proceedings.

Whether the court so relied on the formulation of a subcommittee print is open to question; Under Secretary of Transportation Barnum, who presented a report on the status of pending legislation on behalf of the Government parties at the October 12 hearing, did not mention the September 30 date in his statement, and other government parties specifically noted that "[t]he final form of that legislation remain[ed] to be threshed out." (Hearing transcript, Oct. 12, 1973 at 9869). By November 3, 1973, when H.R. 9142 was reported out by the House Commerce Committee, the provision on consideration had been modified to read

> either the fair liquidation value or going concern value thereof as of September 30, 1973, as provided in the final system plan, *except that in no event shall such rail properties be valued at more than the constitutional minimum required for their acquisition* . . . . (Emphasis added.)

and the accompanying House Report, H.R. Rep. No. 620, 93d Cong., 1st Sess., provided contradictorily at page 53 that "The value of the consideration must equal the fair and equitable value of the rail properties as of the date of the conveyance."

In any event, whatever the judge's desires might or might not have been, no one could give him any such guarantee as the PC Trustees suggest; the only alternative to deferring action that was open to him

was the truly unthinkable one of dismissing the § 77 proceeding just when Congress was on the verge of adopting comprehensive legislation in response to proposals advanced by the PC Trustees with his approval. Even if he had followed such a course and his action had not been stayed pending appeal, an equity receiver would still have had to apply for authority to sell or abandon unless abandonment was forced by the foreclosure of liens. *See United States* v. *27.7 Acres of Land*, 178 F. Supp. 712, 715 (W.D. Ark. 1959); Interstate Commerce Act § 1(3) ("common carrier" includes all natural or artificial persons engaged in transportation as common carriers for hire, and "persons" includes receiver of a company); *id.* § 1(20) (a "receiver . . . acting for" a carrier is liable to criminal penalties for authorizing or permitting any violation of § 1(18)).

31. The court qualified its holding by saying that statutory requirements of obtaining ICC and state commission approval apply "unless such statute inexorably conflicts with the Constitution" but that the record before it did not "demonstrate that such conflict has happened here—at least, not as yet." 485 F.2d at 215; *see id.* n.42. This also appears to have been the situation at the date of the October 12 hearing before Judge Fullam; at no time did he find that continued operation pending applications to the ICC for abandonment or sale under § 77(*o*) would constitute a taking forbidden by the Fifth Amendment in the absence of just compensation. In any event we have previously characterized this statement in the *Central Railroad of New Jersey* opinion as running "counter to the explicit assumption of all courts, including the Supreme Court in the New Haven Inclusion Cases." 384 F. Supp. at 920 n.33.

The Third Circuit's *Central Railroad of New Jersey* decision was followed in *In re Erie Lackawanna Railway*, 517 F.2d 893 (6 Cir. 1975). The court of appeals there reversed an order of the reorganization court, made before the EL became subject to the Rail Act, permitting discontinuance of two Ohio passenger trains where the Ohio commission had delayed for 10 months in acting on the trustees' discontinuance request and the trustees had not applied to the ICC for expedited relief under § 13a(2) of the Interstate Commerce Act. The case is less helpful to the Government parties than the *Central Railroad of New Jersey* decision in that the EL's financial condition at the time was less serious; however, the Sixth Circuit panel did extend the *Central Railroad of New Jersey* rationale to a situation in which an agency

application for discontinuance or abandonment was already pending, *per contra* 485 F.2d at 213.

Many transferors rely on the decision in the so-called Columbus Option case, *In re Penn Central Transportation Co.*, 494 F.2d 270 (3 Cir.), *cert. denied*, 419 U.S. 883 (1974), as dispensing with any requirement of application for authority to abandon. The issue there was quite different. The United States held $100 million of trustees' certificates issued under the Emergency Rail Services Act which constituted a prior lien on the Penn Central's mortgaged assets and also a lien on unmortgaged assets. The United States and the PC Trustees wished to have the proceeds of sale of unmortgaged assets used for operations; the mortgages objected that this would increase the impact of the prior lien of the United States on the mortgaged assets and thus would have a similar effect to use of proceeds of the mortgaged assets themselves and that, in the absence of a finding of prospects of a successful reorganization, this was forbidden by the rule of marshaling. The court sustained this claim. How far it was from upholding the position here advanced by transferors is shown by its remark concerning the Rail Act, 494 F.2d at 283:

> Congress, in devising a legislative solution, will be bound by the fifth amendment to pay the fair value of the Penn Central properties at the time any new rail transportation entity takes them. Any amount beyond that value, which would compensate secured creditors for the erosion which took place while the reorganization court and the ICC waited for a congressional solution, would be a matter of legislative grace. It would be hazardous, indeed, to speculate on the likelihood of favorable exercise of such largess from public funds, especially in view of the form of the legislation recently enacted. (Footnote omitted.)

32. During the course of the § 77 reorganization up to January 1973, the PC Trustees filed applications with the ICC for the abandonment of approximately 3,000 miles of line; applications for abandonment of about 800 miles were granted. We are not told what efforts the PC Trustees made, before the ICC's "freeze" on abandonment proceedings in 1973, *see* 384 F. Supp. at 921-22, to press the applications on which the ICC took no action.

33. The implication for the situation here of Judge Anderson's conclusion and the Supreme Court's seeming approval of it is all the

stronger in that during the two years from 1961 to 1963, when the New Haven was determined to be unreorganizable on an income basis, the Trustees had sought federal and state aid in the form of tax relief and subsidies to allow the New Haven to operate on a breakeven basis. 289 F. Supp. at 456. Despite the fact that no subsidies of adequate size were forthcoming from the interested states or the federal government, Judge Anderson did not consider that the government had lost its entitlement to an abandonment proceeding during which it could examine alternatives for continuing rail service if inclusion of the New Haven in the Penn Central had not seemed possible.

34. We likewise cannot subscribe to the argument that applications to abandon would have been futile in view of the logjam they would have created at the ICC and the "freeze" imposed by the Commission in 1973 and lifted in 1974, *see* 384 F. Supp. at 921-22. While the Commission could not reasonably be expected to deal with abandonment applications of the importance here under discussion in a fast-food manner, we cannot assume that if the Commission had been confronted with applications for total or large-scale abandonment by the PC and the other bankrupt railroads in the Northeast, it would have proceeded on a "business-as-usual" basis or refuse to proceed because of its temporary freeze. We repeat what Judge Adams said in *In re Central Railroad of New Jersey*, *supra*, 485 F.2d at 213 (footnotes omitted):

> There having been no application made, there can be no showing that delay or frustration would be the inevitable result.

35. In fact the record affords no basis for belief that the PC Trustees favorably considered abandonment beyond an 11,000 mile core until early 1973. As will later appear, we take that date, when serious discussion of what became the Rail Act began, as the date when the clock started to run against the Government in the case of the PC.

36. It can, of course, be argued that this burden should be shared by all citizens. But the problem was peculiarly that of the bankrupt railroads, and it seems as legitimate to saddle them with the cost of reasonable legislative as of administrative consideration.

37. Section 5(2) of the Interstate Commerce Act, which requires a rail carrier to seek ICC approval of any sale or lease of rail property to another carrier, would apply to any sale or leasing of rail properties to a state transportation authority that already operated a rail service handling cars moving in interstate commerce, even where the relevant

trackage was located wholly within the acquiring state. *See United States* v. *California*, 297 U.S. 175, 185-86 (1936); *National League of Cities* v. *Usery*, 44 U.S.L.W. 4974, 4980 n.18 (U.S. June 24, 1976); *compare* 45 U.S.C. §§ 1 and 6 ("any common carrier engaged in interstate commerce by railroad"), *with* 49 U.S.C. § 1.

38. We find additional support for this conclusion in Judge Anderson's finding, 304 F. Supp. at 801, and the Supreme Court's apparent approval of his finding, 399 U.S. at 460, 489-90, that an abandonment proceeding for the New Haven would have taken approximately three years, from late 1963 to December 31, 1966; the New Haven proceeding would have involved far fewer considerations of public interest and competitive effect than the abandonment of major eastern carriers that formed an essential adjunct to the services of other carriers serving the west and the south.

39. When we wrote in 1974, the fate of any initial FSP seemed in serious doubt because of the deep split in opinion between the Secretary of Transportation and the Rail Services Planning Office (RSPO) of the ICC over the treatment of low density lines and the popularity of the RSPO's position with local communities. The Secretary's 1974 report *Rail Service in the Midwest and Northeast Region*, Vol. I, at 3, 69-74, concluded that 25 percent of the region's railroad mileage was "potentially excess", because the number of freight carloads originated or terminated on those lines annually fell below the number judged by the Department of Transportation to be necessary for a "high probability of financial viability". Only the lines which had such a high probability were recommended for inclusion in the FSP at that time, with certain exceptions; the others were to be further studied, to see whether the 1972 standard data used was not accurate in the individual case, or whether tariff adjustments could improve their viability. But if the line was eventually found to be "excess", according to the Department's profitability criterion, its continued operation was said to be up to the States, local communities, and shippers, who might want to undertake subsidization of the line under § 304(c) of the Rail Act, or to acquire it.

As noted in our 1974 opinion, 384 F. Supp. at 921 n.36, the public hearings conducted by the RSPO on this report aroused great public reaction, in part because of uncertainty as to what was meant by the designation of a line as potentially excess, but in larger part because of disagreement with the use of line-by-line profitability as the sole criterion for continuation of service.

> Witness after witness described the adverse economic, social, and environmental impact such actions would have on communities. It was contended that rail service discontinuances would result in market distortions, economic depression and social dislocations. Moreover, it was repeatedly stated that rail discontinuance is inconsistent with our national environmental and energy conservation policies.
>
> * * *
>
> A number of witnesses took issue with the DOT Report's assumption that alternate modes of transportation could fill in the gap if major reductions in rail service were effectuated.

RSPO, *Evaluation of the Secretary of Transportation's Rail Services Report*, at 10 (May 2, 1974). The Planning Office's own recommendations were that USRA

> should reject the Secretary's method of determining branch line viability which was based primarily—if not solely—upon the number of carloads handled.

and

> should consider lines as segments of a total system and evaluate their capabilities for contributing to overall system efficiency, rather than requiring that each line or mile of track meet a test of independent profitability.

Id. at 3, 4. The fight over abandonment criteria continued during 1975, *compare* I Preliminary System Plan at 6, 15, 20 (February 26, 1975) *with* RSPO's *Evaluation of the Preliminary System Plan* at 6, 49-57 (April 28, 1975), but did not delay Congressional acceptance of the Final System Plan.

40. We do not mean this permission to be read as an open-ended invitation to burden these proceedings with consideration of possible abandonment of small branch lines now seem to be desirable by hindsight; we are referring to abandonments of major significance to a particular carrier, *e.g., the Ann Arbor's car ferry operations* (*see* Section V(E)), even though not of its entire property. The trustees would also have the burden of showing that they were in fact ready to propose such abandonments. *see* fn. 14 *supra*.

41. In the absence of some measure of agreement on the guidelines with respect to putative abandonment proceedings such as we urge in Section VI of this opinion, we shall doubtless wish to arrange a conference on this subject during the next few months. It may be that the taking of evidence with respect to the dates when abandonment applications would have been filed and should have been concluded should be confided to a single master or to a member of this court rather than assigned to a number of masters dealing with different properties. The project here suggested, however, may turn out to be so closely related to the problem of an "alternative scenario" to be discussed in our CMV opinion that, in the absence of agreement, the interests of all parties would be served by consolidating the two.

42. These sections authorized the Secretary of Transportation to provide funds to the railroads prior to conveyance. Section 213, as amended, provides for $282 million to be paid to railroad trustees "as . . . necessary for the continued provision of essential transportation services." Section 215, as amended, authorizes the financing with $300 million in obligations of agreements between the Secretary and the trustees for three purposes:

> (1) to perform the program maintenance on designated rail properties of such railroads until the date rail properties are conveyed under this Act;
>
> (2) to improve rail properties of such railroads; and
>
> (3) to acquire rail properties for lease or loan to any such railroads until the date such rail properties are conveyed under this Act, and subsequently for conveyance pursuant to the final system plan, or to acquire interests in such rail properties owned by or leased to any such railroads or in purchase money obligations therefor.

Funds under either section used for program maintenance or improvement of designated properties are subject to § 215(b)(1), which provides that

> to the extent that physical condition is used as a basis for determining, under section 206(f) or 303(c) of this Act, the value of properties subject to such an agreement and designated for transfer to the Corporation under the final system plan, the physical

condition of the properties on the effective date of the agreement shall be used . . . .

We have previously indicated that § 213 "provid[es] for grants rather than loans" and that § 215 advances "are not debts of the estates of the borrowing railroads, although they must be assumed by Conrail." *In re Penn Central Transportation Company*, 384 F. Supp. 895, 909 & n.17 (1974). The Government's brief, at 27, characterizes § 213 aid as "grants" and § 215 assistance as "loans to ConRail that for present purposes are effectively grants to the transferors." On March 31, 1976, the Secretary of Transportation and USRA agreed, pursuant to § 215(c), to release ConRail from all but approximately $43 million of the obligations incurred in financing the § 215 expenditures.

The following tables show what aid was provided each railroad:

§ 213

	Grants made	*Disbursements*	*Balance available under existing grants*
Penn Central	$187,718,003	$187,718,003	$ —
Central of New Jersey	22,320,000	22,320,000	—
Lehigh Valley	8,550,000	8,125,000	425,000
Erie Lackawanna	31,696,956	31,696,956	—
Ann Arbor	4,687,000	4,687,000	—
Reading	7,970,000	7,850,000	120,000
Lehigh & Hudson River	796,807	796,807	—
Total	$263,738,766	$263,193,756	$545,000

Source: Report of the Comptroller General of the United States (CED-76-161) (Nov. 15. 1976).

Appendix C

§ 215

	Approved Its Program	*Expenditures*	*Compounded Balance*
Funds Applied:			
Program Maintenance:			
Penn Central Agreement—754	$ 85,000,000	$ 83,412,677	$1,537,323
Penn Central Agreement—755	69,300,000	69,222,369	77,631
Erie Lackawanna Agreement—756	1,900,000	1,878,610	21,390
Erie Lackawanna Agreement—757	8,100,000	8,030,634	69,366
Central of N.J. Agreement—753	1,200,000	1,085,584	114,416
Central of N.J. Agreement—759	500,000	420,305	79,695
Reading Agreement—7513	50,000	-0-	50,000
Reading Agreement—7514	3,630,000	3,647,458	2,542
Lehigh Valley Agreement—7511	2,500,000	2,166,520	333,480
Lehigh Valley Agreement—7512	3,762,000	3,454,903	307,097
Program Maintenance, Total	175,962,000	173,319,060	2,642,940
Maintenance of Way Machinery:			
Penn Central Agreement—751	14,700,000	13,727,973	972,027
Erie Lackawanna Agreement—7516	110,000	95,331	14,669
Lehigh Valley Agreement—7517	500,000	494,906	5,094
Maintenance of Way Machinery, Total	15,310,000	14,318,210	991,790
Lehigh Valley Locomotives:	3,450,000	3,435,096	14,904
Equipment Obligations:			
Erie Lackawanna Agreement—7518	7,800,000	7,794,543	5,457
Reading Agreements 7521 & 7523	1,650,000	1,645,257	4,743
Penn Central Agreements 7522 & 7529	33,550,000	32,260,026	1,289,974
Ann Arbor Agreement—7531	90,000	85,510	4,490
Central of N.J. Agreement—7519	464,800	-0-	464,800
Equipment Obligations, Total	43,554,800	41,785,336	1,769,464
Maintenance & Equipment Program:			
Penn Central Agreement—7515	53,200,000	53,135,844	64,156
Interest Expense:			
Gross Expense		7,796,491	
Interest Income		689,500	
Net Expense	7,500,000	7,106,991	393,009
Capital Projects and MNV Cars:			
Penn Central Agreement—761	290,000	289,0000	1,000
Available for Other Use	733,200	-0-	733,200
Total	$300,000,000	293,389,537	$6,610,463
Cash in Bank		49,866	
Total funds applied		$293,439,403	

SOURCE: Third Annual Report of the United States Railway Association at 22 (June 30, 1976).

43. We do not think that the Penn Central gains anything from the additional claim that the government guarantee of its trustees' certificates under the Emergency Rail Services Act of 1970, 84 Stat. 1975, amounted to governmental aid forced upon it. These benefits were received at a time when the PC Trustees clearly contemplated a successfully reorganized railroad and urged enactment of a federal loan or guarantee scheme, *see* Hearings on Emergency Rail Services Legislation Before the Subcom. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d Sess., at 496-509 (1970), as did PC management, *see id.* at 247, 251, 252, 268, 367, although the Penn Central Company submitted a separate statement opposing direct federal loans, *see id.* at 579-80.

The PC's reliance on the receipt in August 1973 of approximately $16 million in loans under the Emergency Rail Facilities Restoration Act of 1972, 86 Stat. 1304 (the "Storm Agnes" legislation), stands on even weaker ground unless one is willing, as we are not, to accept the proposition that the railroads' "cashlessness" claims are strengthened by efforts of the government to abate the effects of natural disasters. The funds provided in August 1973 were largely designed to restore railroad facilities to their pre-storm condition and not as part of a long-range response to the financial plight of the railroads.

44. Northeast Rail Transportation Hearings Before the Subcomm. on Transportation and Aeronautics, House Comm. on Interstate and Foreign Commerce, 93d Cong., 1st Sess., pt. 1, at 246 (1973).

45. We think this is so despite the absence of a uniform favorable response to the legislative proposals of 1973 by the various trustees. Our review of the congressional hearings held during 1973 convinces us that although none wholeheartedly welcomed the legislation that became the Rail Act, neither did any transferor except the CNJ Trustee object as clearly or as vociferously as some now claim. Certainly the Penn Central did not object with the fervor it now contends, *see* Hearings on Northeast Rail Transportation Before the Subcomm. on Transportation and Aeronautics, House Comm. on Interstate and Foreign Commerce, 93d Cong., 1st Sess. 245-54; Hearings on the Northeastern Railroad Transportation Crisis Before the Surface Transportation Subcomm. of the Senate Comm. on Commerce, 93d Cong., 1st Sess. 392-407, 888-902. Instead, the various trustees generally testified as to the condition of their respective roads and then in rather vague terms noted what features federal legislation for continued rail operation should contain, only some of which were at odds with the emerging Rail Act.

46. We likewise cannot accept the argument that the Rail Act itself was the Government's solution and all erosion after its passage thus must be a taking. The Rail Act was not a solution but rather afforded the framework for achieving one, and the total time spent in considering and implementing the law was not unreasonably long. How the case would stand with respect to erosion if the process of the Rail Act had not succeeded is an issue we happily need not decide.

47. The Norwich & Worcester Railroad, the nature of whose operation is described in *Norwich & Worcester Railroad* v. *United States*, 408 F. Supp. 1398, 1400 (1976), and the Peoria & Eastern Railroad, which was operated by PC under an agreement, have filed briefs in which they take the position that whatever disposition is appropriate for PC's CUE claims will be appropriate for them. We think it fair to allow these railroads, if so advised, to attempt the showing indicated in text *supra*.

48. Unhappily the Government parties did not favor us with detailed briefing with respect to these claims, including the characterizations by the several roads of their financial and reorganization histories on which they are based. As a result, although we have done our best to check and supplement the histories recounted in the Trustees' briefs from such materials as are available to us, we have had to rely in considerable part on the Trustees' submissions. Of course the Government is still free to take issue with any of these submissions if and when the Trustees attempt the showing we have required for entitlement to pre-conveyance CUE.

49. This phrase requires some elucidation in view of what seems to have been the prevalent assumption that the trustee of a losing railroad in a § 77 proceeding could disregard § 1(18) of the Interstate Commerce Act. As previously indicated we regard this assumption as erroneous except when cessation of operations would have been required by "cashlessness" or other circumstances beyond a trustee's control. However, in view of the climate prevailing in 1975, the phrase "would have filed for abandonment" should be read to include an application to the reorganization court for authority to cease operations.

50. Counsel construed the reservation as including post-bankruptcy tax claims together with any post-bankruptcy administration claims. *See* Transcript of argument, 124-25.

51. Authorization was later granted, *R. D. Timpany, Trustee of the Central Railroad Co. of New Jersey—Abandonment of Operation*

Between Phillipsburg, N.J. and Hudson, Pa., 342 I.C.C. 227 (1972), and the reorganization court then authorized abandonment with compliance by the trustee with certain conditions laid down by the ICC, *see In re Central Railroad of New Jersey*, 486 F.2d 1124, 1126 (3 Cir. 1973), *cert. denied*, 416 U.S. 938 (1974).

52. After rejecting the claim that it was bound to follow the decision on the Pennsylvania abandonment as "law of the case" and *stare decisis*, the en banc court distinguished the earlier decision on the ground that there applications for abandonment were pending and the ICC "arguably unduly delayed" action on them. 485 F.2d at 210-11.

53. To wit, the LV, the Reading and the Western Maryland.

54. The reorganization court's denial of leave to the State of Pennsylvania and its Public Utility Commission to seek judicial review of these ICC decisions in another district court was affirmed by the Third Circuit, which noted that no appeal had been taken from the reorganization court's order sanctioning the CNJ's retirement from Pennsylvania and that the reorganization court could have convened a three-judge court under the Urgent Deficiencies Act, former 28 U.S.C. §§ 2321-25, if timely application to it had been made. *In re Central Railroad of New Jersey*, 486 F.2d 1124 (3 Cir. 1973), *cert. denied*, 416 U.S. 938 (1974).

55. These included negotiations with the Chessie for a lease of CNJ's freight facilities; a merger with LV and the Reading; and other discussions between the Trustees of the LV and the CNJ.

56. The Trustee admits that a contributing factor to the breakdown in these negotiations was the defeat of Governor Cahill of New Jersey in the Republican primary in June 1973 and his administration's subsequent understandable position that any changes in the contract should be left to his successor. We fail to see how the United States has any responsibility for this; the CNJ operates in a democracy and must take such interregna as part of the process.

57. The Trustee's Preliminary Plan of Reorganization, dated June 15, 1973, contemplated the filing by November 23, 1973 of either a plan of reorganization or, should federal relief not be forthcoming, a petition for cessation of operations and liquidation.

58. Substantially the same point was made by the Commonwealth of Pennsylvania in the Reading's reorganization court: in its memorandum in opposition to the Institutional Investors Reading Group's amended petition, the State argued among other things that cessation required a § 1(18) certificate and that the ICC must pass on any reorganization plan.

59. The Reading also argues that by December 1, 1973 it was entitled to cease operations and commence liquidation without any further judicial or administrative proceedings since at that time the road lacked sufficient reserves and current assets to cover operating expenses (including those necessary for liquidation) and leave enough capital for an orderly liquidation. An affidavit of John A. Brennan, Jr., submitted in support of this claim, indicates that the Reading has included in the "current liabilities" taken into account liabilities that would become current upon cessation, equipment obligations due within one year, and a large item for unspecified "miscellaneous" liabilities. In addition, this affidavit points to the Reading's receipt of §§ 213 and 215 funds as staving off a forced cessation in 1975 and the first quarter of 1976. Apart from the fact that the Reading's claim of "cashlesness" as to December 1, 1973 seems to go beyond the exception we would recognize for truly forced cessations, the role of governmental assistance in preventing cessation no more favors the Reading than it does for Penn Central.

60. The Reading further claims an independent right to CUE from January 1, 1975 on the ground that from then onward § 213 funds were made more freely available to the other roads than to it because of the Reading's comparatively strong cash reserves. We do not see, however, how this allegedly "discriminatory" application of § 213 gives rise to any special entitlement to CUE. If the Reading depleted its cash reserves during this period, then it can include this as an element of erosion for which it will be entitled to compensation if it can make the showing we describe in text necessary for any CUE payments. A railroad has no special right to erosion compensation because its continued operation had a particularly severe impact on one category of its assets -- in the Reading's case, cash.

61. In light of our discussion above of this general argument, we need not further discuss the LV claim that the Trustees' 1973 termination petition demonstrates a cash position that entitled it to immediate

cessation of operations as of October 1, 1973 within footnote 31 of our 1974 opinion.

62. In 1966 overhead loaded traffic constituted 96.1% of the L&HR's business. By 1972 the proportion had fallen to 83.6%, as a result of loss of the bridge traffic rather than any significant increase in originated or terminated traffic.

63. The L&HR had no mortgage liens.

64. All told EL received $27.9 million in grants for wages and operating costs and $3.8 million for equipment obligations under § 213 and $7.8 million for such obligations and close to $10 million for maintenance of its properties pursuant to § 215 — an aggregate exceeding $49 million.

65. Indeed, as the Government parties argue, it is quite remarkable that EL's belated entry did not force USRA to request a further delay for the submission of FSP.

66. Some support for the latter alternative may be found in § 3(b)(4) of the Emergency Rail Services Act of 1970, 84 Stat. 1976, which provided that the Secretary of Transportation, after consultation with the ICC, shall require as a condition to a government guarantee of trustee certificates under the Act that

> in the event of actual or threatened cessation of essential transportation services by the railroad, the Secretary shall have the option to procure by purchase or lease trackage rights over the lines of the railroad and such equipment as may be necessary to provide such services by the Secretary or his assignee, and, in the event of a default in the payment of principal or interest as provided by the certificates, the money paid or expenses incurred by the United States as a result thereof shall be deemed to have been applied to the purchase or lease price. The terms of purchase or lease shall be subject to the approval of the reorganization court and the operation over the lines shall be subject to the approval of the Commission pursuant to the provisions of section 5 of the Interstate Commerce Act, but in no event shall the rendition of services by the Secretary or his assignee await the outcome of proceedings before the reorganization court of the Commission.

Another possibility was the ICC's legislative proposal, H.R. 6591, which provided for a lease and leaseback arrangement between the bankrupt lines and the United States for a period not to exceed three years with the difference between revenues and operating costs subsidized by the federal government. *See Penn Central Transportation Company Reorganization,* 347 I.C.C. 45, 121 (Sept. 28, 1973).

67. The House Report, H.R. Rep. No. 620, 93d Cong., 1st Sess. 28 (Nov. 3. 1973), accompanying H.R. 9142, set forth the basic views of the Committee on Interstate and Foreign Commerce concerning a federal solution as follows:

> This Committee decided from the beginning that any legislation it would report to the House would not be a "Creditors Relief bill." The Committee feels that in our free enterprise system, investments should be made freely without a public guarantee that the investment will reap profits for the financier. The investors and creditors of the bankrupt carriers took certain business risks and should not expect the American taxpayer to "bail them out" merely because their investments were failures. And too, the investors, and creditors of railroads know before they make such investments of the traditional and historic "public interest" character of the industry. In short, the investment fortunes of a few cannot override the economic fate of the nation.
>
> The Committee also decided that the public interest would not be served if these bankrupt carriers were shut down and sold on the "auction block." The services these carriers perform are essential to the nation and the blow to the economy if such services were interrupted only briefly, would be devastating. This is a matter which affects not only the economy, but also the defense needs of the nation. The future of rail transportation in the Northeast transcends the interests of not only the investors, the creditors, the managers and trustees, and the people and the industries of the Northeast region—it is an American problem, one affecting all of us.
>
> The Committee further decided that the economy could not sustain nationalization of the rail industry in the North, nor would it be good public policy. The Committee fervently believes that private enterprise must flourish in the transportation industry, and that it would set a precedent for not only the rail industry, but all transportation needs, if the government became the owner and operator of the Northeast rail carriers.

> Recognizing the public necessity of a viable, functioning rail system, and the importance it has in our nation, the Committee acknowledges that some federal assistance is an absolute necessity to assist in the restructuring of the system. No one judge can accomplish the complex restructuring of all rail carriers in the region, and the problem cannot be isolated by individual carrier—all bankrupt carriers in the region must be considered in any legislature solution.

Similarly, referring to the use of a new corporation's securities to pay for the transferred properties and use of federal loan guarantees instead of grants, the report of the Senate Committee on Commerce S. Rep. No. 601, 93d Cong., 1st Sess. 18 (Dec. 6, 1973), accompanying S.2767, explained that "the very process by which the bill would create a new healthy railroad out of the bankrupt ones arose from th[e] strong desire to limit the use of Federal money." Congress was rather clearly concerned with minimizing the cost to the federal government and avoiding the perception of either a "bail-out" or "nationalization": these concerns would hardly have engendered federal responses that would have put the erosion burden as well as the conveyance cost squarely on the federal government.

68. Our many references to the need of proving the consummation of an abandonment or sale are not to be taken as excluding proof that a purchaser might have obtained authority to operate on an interim basis or have agreed to absorb part or all of interim losses.

69. Agreements of this sort could, of course, be without prejudice to the rights of either side to have the basic elements of our decision with respect to the accrual of pre-conveyance CUE reviewed by the Supreme Court.

APPENDIX D

Appendix D

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Special Court—Misc. No. 76-1

Filed July 5, 1977, James F. Davey, Clerk

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

On Motions for Reconsideration of Opinion of April 19, 1977 on Compensable Unconstitutional Erosion (CUE).

PER CURIAM:

On April 29, 1977 the PC Trustees moved for reconsideration of our opinion of April 19, 1977, dealing with compensable unconstitutional erosion (CUE). A number of other transferors and the PC Company joined in the motion. Because of uncertainty as to the proper date for seeking reconsideration of rulings of this court, we issued a notice fixing May 25, 1977, as a date by which motions for reconsideration of our CUE opinion could be filed and permitting the Government parties to answer by June 7. A number of other parties subsequently joined in the motion of the PC Trustees, the Government parties filed a response, and the PC Trustees and others, with our permission, have filed a reply.

Although the PC Trustees, stating their intention to raise on appeal their disagreement with the "basic framework" of our opinion, limit themselves to three grounds hereafter discussed, we think it wise also to advert to their preliminary criticisms that "the Court had no basis on the record, for example, for suggesting

that the cessation of operations by Penn Central would necessarily have required environmental impact statements, or for now expressing its conviction that '. . . it would have been impossible [for Penn Central] to complete abandonment proceedings before April 1, 1976.' (Op. at 37.)" Although the need for environmental impact statements with respect to abandonments effected through ICC proceedings has been taken as a given in all this court's proceedings, see *180-Day Appeals*, 384 F. Supp. 895, 922 (1974), if the PC Trustees or others wish to attempt showings that such statements might have been dispensed with, they are free to do so. Similarly, our remark as to the impossibility of obtaining ICC authority to abandon the entire PC operation by April 1, 1976 even if an application had been filed early in 1973 expressed our strong conviction; it should not be taken as precluding an attempt at contrary proof, see Op. at 39.

We turn now to the three specific points urged in the motion:

(1) The PC Trustees ask us to make clear that, in connection with efforts to demonstrate the feasibility of a cessation of operations prior to April 1, 1976, we should allow proof that the transferors would have become "cashless" prior to that date and, indeed, that the Government parties should have the burden of proving that they would not have. This argument is based on a misunderstanding of pp. 41-43 of our opinion. In the absence of the Rail Act, the transferors' "Brooks-Scanlon rights" would have accrued on a cessation of operations (a) for which the ICC had granted leave or at the end of a reasonable time for the ICC's acting on applications for such leave, or (b) on the transferors' attaining "cashlessness," whichever was earlier. We held there would be no erosion taking if the Government, by providing emergency financial aid, postponed (b) to—but not beyond—(a). The notion of hypothetical applications for leave to cease operations (including the qualification that, generally speaking, these may be considered to have been filed in early 1973) was used by us to determine how long the Government could constitutionally

require operation even after what, absent the Rail Act, would have been the point of cashlessness. It is thus irrevelant that, as the PC Trustees contend, absent the Rail Act or some other form of interim assistance, they would in fact have reached the point of cashlessness before an application for leave to cease operations could have been carried to a conclusion and operations were discontinued.

(2) The PC Trustees' second point is that in light of the ICC's decisions in *Okmulgee Northern Ry. Co. Abandonment*, 320 I.C.C. 637 (1964), which had not been called to our attention in the briefing on CUE, and subsequent ICC cases, we were in error in supposing that an application for sales to other railroads or, in some instances, to public bodies would have required approval under § 5(2) of the Interstate Commerce Act, see Op. at n.37. The PC Trustees read these cases as holding that when the applicant is seeking to abandon all of its railroad operations, authority under § 1(18) [now slightly amended as § 1a(1)] is all that is required. The Government parties question the correctness of *Okmulgee* and its progeny and their applicability to transactions of the magnitude that would have here been involved. As the Government parties also suggest, there is no need to determine these questions until we know what the transferors say they would have proposed. If they wish to contend that the ICC could have authorized these solely under § 1(18) and that this would have been materially different from authorization under § 5(2) in procedure or result, they are free to do so.

(3) The final point made by the PC Trustees, namely, that the Rail Act itself operated as an erosion taking, was fully considered by us, see Op. at n.46, and we find no need for further discussion of it.

Appendix D

Except as herein indicated, the motions for reconsideration are denied. In light of § 303(d) of the Act and the summer recess of the Supreme Court, we shall postpone the effective date of this order of denial until November 1, 1977.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

Dated: July 5, 1977

APPENDIX E

Appendix E

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Misc. No. 76-1

Filed October 12, 1977, James F. Davey, Clerk

In the Matter of the
Valuation Proceedings under Sections 303(c) and 306
of the Regional Rail Reorganization Act of 1973

Before:

FRIENDLY, *Presiding Judge*, and
WISDOM and THOMSEN, *Judges*.

Opinion with respect to issues set for briefing and argument as Subjects (4) and (6) of Schedule attached to Memorandum and Order of June 16, 1976, 425 F. Supp. 266, 289 (Sp. Ct. 1976), as supplemented by Notices of December 15, 1976 and April 14, 1977.

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Appendix E

FRIENDLY, *Presiding Judge:*

I. *Introduction*

In this opinion we continue the discussion of the nature of the Rail Act in Part III of our opinion of October 18, 1976, 425 F. Supp at 270-71, and shall consider the constitutionality of compensating the transferors in other than cash, an issue on which we requested briefing by our notice of April 14, 1977. We shall also deal with certain of the issues outlined in our Memorandum of June 16, 1976, 425 F. Supp. 266, 281-87, relating to the determination of net liquidation value (NLV) under § 306 of the Rail Act, of constitutional minimum value (CMV), and of value of other benefits (VOB). In accordance with our Memorandum of June 16, 1976, 425 F. Supp. at 289, opening briefs on the issues of NLV, CMV, and certain other matters were received on January 6, an answering brief of the Government parties on February 20, and reply briefs on March 18, 1977. By order of December 15, 1976, we set a schedule with respect to the VOB issue which required initial briefs to be exchanged on February 22, 1977 and further briefs on March 18, 1977. We heard oral argument on April 12 and 13, 1977. In the meanwhile, discovery has been continuing under the supervision of Judge Thomsen.

As indicated in the Memorandum of June 16, 1976, 425 F. Supp. at 277-78, the court believed that extensive briefing and argument of certain general questions at this time would permit us to announce our views with respect to a number of legal issues and enable us to establish procedures for the further conduct of the necessarily complex valuation proceedings required by the Rail Act, and thereby reduce the time and expense, huge under the best of circumstances, which will be required to conclude this case. We thought then, and we think now, that simply to appoint a number of special masters who would be set loose without any guidelines from us "would produce utter chaos," 425 F. Supp. at

277.[1] We remain convinced of the wisdom of proceeding in the manner outlined in our June 16, 1976 Memorandum, even though it now appears that decision on some issues that have been briefed would be premature. Even as to such issues the efforts of counsel will not have been wasted, since these questions, or most of them, will have to be decided at a later date.

II. *Reorganization* v. *Eminent Domain: The Propriety of Compensation Other than Cash*

In our memorandum of June 16, 1976, we noted that "a question lurking in the case is whether the standard of valuation should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both," 425 F. Supp. at 280 (footnote omitted), and requested that this issue be included in the first round of briefing. Responding to such briefing in our opinion of October 18, 1976, 425 F. Supp. at 270-71, we said that perhaps the question could be more accurately stated as being whether the Act involves a taking and, if so, whether the 'constitutional minimum' required both by the terms of the Act and by the Fifth Amendment differs if the Act should be regarded as a reorganization statute enacted under the bankruptcy power or as a statute enacted under the commerce power or as both. For reasons there developed, we deferred decision until after the final round of briefing and argument called for by our June 16 Memorandum.

The issue has lost much of what once seemed to be its significance because of the concession of the Government parties (Brief at 12):

---

1. We say this despite our recognition that any determinations made by us are subject to review by the Supreme Court. Section 303(d) of the Rail Act, as we read it, would permit the Court to review this opinion now, despite its interlocutory character, if the Court should deem that to be wise—a question on which, of course, we intimate no view.

> We do not contend that the Act cannot involve a "taking" or that the Fifth Amendment standard differs depending on which powers Congress invokes.

See also id. at 14-15. Indeed, it now appears that the chief, if not the sole, importance of the question how far the Act is a reorganization statute may be in its bearing on the issue framed in our notice of April 14, 1977:

> whether payment in the manner provided in the Rail Act, namely, that net liquidation value shall be paid in securities of ConRail and certificates of value and that only the excess of constitutional minimum value, if any, as finally determined, shall be paid in cash, is constitutional.[2]

A large step toward answering this question was taken by the Supreme Court in the *Rail Act Cases*, 419 U.S. 102 (1974). The plaintiffs there asserted

> that the Rail Act is basically an eminent domain statute and, because compensation is not in cash but largely in stock of an unproved entity, will necessarily work an unconstitutional taking. A variant of the argument is that, even if a reorganization statute, the Rail Act would be unconstitutional unless the Tucker Act remedy is now held to assure payment of any amount by which the *market value* of stocks and securities awarded by the Special Court is less than the value of the rail properties conveyed.

419 U.S. at 137 (emphasis in original; footnote omitted).[3] The Court held that the bankruptcy power authorized Congress to provide a mix of ConRail securities and USRA obligations in

2. The Notice also requested discussion whether a distinction should be drawn between bankrupt and nonbankrupt transferors or between specific classes of nonbankrupts.

Briefs were received on June 1 and reply briefs on June 22, 1977.

3. The Supreme Court elsewhere stated that the plaintiffs' "principal contention" was, in part,

payment for the properties to be conveyed to ConRail[4] and that any taking compensable in cash was limited to the "shortfall" between the value of the properties and the value of the consideration which the Rail Act provided, 419 U.S. at 150-56. Although, as a result of the 1976 amendments' substitution of the certificates of value (CV's) for the USRA obligations provided in the Rail Act as initially adopted,[5] the "shortfall" will be different and, in all probability, less, the Supreme Court's analysis remains broadly applicable.

> that the ConRail securities and USRA obligations and other benefits to be received would not be the constitutionally required equivalent of the rail properties compelled by § 303(b) to be transferred.

419 U.S. at 117-18. *See also id.* at 147:

> [W]e hold ripe for adjudication the questions . . . whether stocks, however valued, can be part of the consideration for the rail properties. . . .

4. In light of the Government's concession referred to above, the problem of the respective reaches of the bankruptcy and commerce power has no practical importance with respect to properties conveyed to profitable railroads or to states. In those instances, the transferors will receive compensation in cash from the transferees. *See* Sections 206(d)(2), 303(a)(2). If this Court finds that the terms of any such transfer are not fair and equitable, it is to enter a judgment against the transferee. Section 303(c)(3). The United States will be required to indemnify the transferee against the costs of any such judgment. Section 303(c)(5).

5. Section 210 of the Regional Reorganization Act of 1973 authorized the Association to issue obligations, guaranteed by the Treasury, not to exceed $1.5 billion, of which $500 million could be used for acquisition of the properties of railroads in reorganization. *See* H.R. Rep. No. 93-744, 93d Cong., 1st Sess. 60 (1973). The 1976 Amendments limited the amount of USRA obligations, restricted their use to loans pursuant to § 211, and created certificates of value. We described the workings of these certificates in our June 16 opinion, 425 F. Supp. at 276-77. In essence, they are a means of ensuring that the transferors receive obligations carrying the full faith and credit of the United States for the net liquidation value (NLV) of their property, independent of the Tucker Act remedy for any excess of constitutional minimum value (CMV) over NLV. Indisputably the transferors are better off with the CV's than with the limited amount of guaranteed USRA obligations they could have received under the 1973 Act.

Various transferors[6] point out that the only estate before the Court in the *Rail Act Cases* was the Penn Central (PC) and that the decision thus is not conclusive on other bankrupt estates and certainly not on the nonbankrupts. Certain bankrupt transferors contend that while the Court could fairly have concluded that the Rail Act was in part a reorganization statute as to the PC in view of its preponderant share in the properties to be conveyed to ConRail and the ConRail securities to be received, the situation of the other lines is quite different since the ConRail securities will represent predominantly the earning power of PC's transferred properties whereas their properties may have proportionately higher earning power and that this disparity would not necessarily be taken care of by the allocation of the ConRail securities issuable in consideration of the conveyances since they would still be afflicted by the assumed low earning power of the PC assets. The non-bankrupt transferors repeat this argument and further contend, citing *Callaway* v. *Denton,* 336 U.S. 132 (1949), that the bankruptcy power does not extend to them; they refer to the Government's concession on the 180-Day Appeals, which we have permitted it to withdraw, *Norwich & Worcester R.R.* v. *United States,* 408 F. Supp. 1398, 1405 (Sp. Ct. 1976), "that no contention was being made that the acquisition of rail properties from nonbankrupts would be on any other than an eminent domain basis," *see* Final System Plan (FSP), Vol. I at 127-28.

The first contention need not detain us long. While the Supreme Court's decision is conclusive only with respect to PC, the Court was well aware that the Rail Act operated similarly with respect to the other bankrupt railroads, *see* 419 U.S. at 108-17; if the Court had thought that the Rail Act must be characterized differently as to the other bankrupt estates, it surely would have said so or at least entered a *caveat,* particularly since in our opinion in the 180-Day Appeals, 384 F. Supp. 895, 951-52 (Sp.

6. We include in the word "transferors" the intervenors allied in interest with them, 425 F. Supp. at 288.

Ct. 1974), with which the Court was entirely familiar, we had dealt with and rejected a contention very similar to that here considered. Far from qualifying its holding, the Supreme Court flatly stated,

> [W]e believe that there is nothing in the Act fundamentally at odds with the expressed purpose of Congress to supplement the reorganization laws, see H. Rep. 29, and, with the Tucker Act, the Rail Act is valid as a reorganization statute.

419 U.S. at 150.

In contrast, the nonbankrupts are right in saying that, in light of the concession of the Government parties in the 1974 proceedings, noted in the portion of this Court's opinion written by Judge McGowan, 384 F. Supp. at 963-64, that any taking of their properties under the Rail Act would be an exercise of eminent domain, our decision in the 180-Day Appeals cannot be read as holding that as to them the Act was in part a reorganization statute and that a taking occurred only with respect to the "shortfall" between the constitutional minimum value of their property and the value of the consideration they ultimately will receive. We shall likewise assume in their favor that the Supreme Court did not consider whether its analysis would apply to them. However, we now hold that as to them also the Rail Act is a valid reorganization statute and that payment may be made in securities of ConRail and CV's with cash payable only for any "shortfall." While Congress recognized the distinction between bankrupt and nonbankrupt railroads, *see* § 303(c)(1)(A), and directed this Court to make separate findings regarding the constitutional minimum value of profitable railroads, *see* H.R. Rep. No. 93-744, *supra* at 59 (1973), the Act in other respects applies equally to the rail properties of "railroads in reorganization in the region," § 206(c)(1), and to "railroads leased, operated or controlled by any railroad in reorganization in the region." *Id.*

The nonbankrupts had agreed that their properties should be operated, in most cases for many years as an integral part of railroad systems that are now bankrupt. These roads depended financially on rental or similar payments from the bankrupts. Most, although not all, were controlled by the bankrupts, a considerable number to the extent of being wholly owned.[7] As the Government parties note (Brief at 246, n.286):

> Few of the nonbankrupts employed their own personnel or operated their own rolling stock; and most, according to their financial statements, passively received income from sources such as rentals, dividends, interest, and the sale of property. Many were "profitable" only because they continued to state uncollected rentals as income.

The nonbankrupts formed an integral part of the bankrupt systems; indeed the shipping and traveling public had no notion of their separate existence. Most of them had no rolling stock and for this and other reasons could not be operated except in connection with the bankrupt system of which they had so long formed a part[8] to the extent that they could have resumed independent operations, this is one of the options foreclosed by the Rail Act to be considered in determining the NLV and CMV and, accordingly, the extent of the "shortfall." In exercising the bankruptcy power Congress may act on the basis of reality rather than under

7. Of 52 nonbankrupts, 42 were controlled by primary debtors or their subsidiaries, and 22 of these were 100% owned by primary debtors. Of 31 leased lines, 20 had leased their properties to a primary debtor in perpetuity or for terms of 999 or 990 years, and an additional nonbankrupt was under a 401 year lease.

8. For example, neither the Norwich & Worcester nor the Little Miami railroads had operated their own lines for over 100 years before enactment of the Rail Act. North Pennsylvania Railroad had not operated its line since 1879. As of December 31, 1973, the Norwich & Worcester had three employees. On the same date in 1974, the Northern Pennsylvania also had three employees; the Philadelphia, Germantown & Norristown Railroad had one. And as of December 31, 1975, the Baltimore & Eastern Railroad had three employees, the Little Miami, two. *See Moody's Transportation Manual* (1976).

the constraints of corporate forms that had no substantial meaning to anyone until the northeastern railroads underwent a financial crisis which imperiled their continued operation in the public interest. It is appropriate to quote Mr. Justice Sutherland's remarks in *Continental Bank* v. *Chicago, Rock Island & P. Ry.*, 294 U.S. 648, 668, 671 (1935):

> From the beginning, the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power.
>
> . . . And these acts, far-reaching though they may be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.

Cf. Capital Telephone Co., Inc. v. *FCC*, 498 F.2d 734, 737 (D.C. Cir. 1974), where the court permitted the FCC to "look beyond the corporate entity" in order to achieve the "fair and equitable distribution of radio service" mandated by the Communications Act.

Callaway v. *Benton, supra*, 336 U.S. 132, is not to the contrary. As we observed in *Norwich & Worcester R.R.* v. *United States, supra*, 408 F. Supp. at 1404-05, that case "does not hold at all that the bankruptcy power could not extend to the rail properties of solvent lessors of railroads in reorganization. So far as here relevant, it held only that § 77 of the Bankruptcy Act did not purport to do so."[9]

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9. The nonbankrupts also rely on the statement of the court of appeals in *Benton* v. *Callaway*, 165 F.2d 877, 882 (5 Cir. 1945), *aff'd*, 336 U.S. 132 (1949), that

> A solvent corporation, which has appeared specially as creditor and lessor in a reorganization proceeding, cannot be constitutionally compelled against its will to convey to the debtor a larger and better title than was granted in the lease.

Appendix E

The considerations that led the Supreme Court to conclude in the *Rail Act Cases* that securities of ConRail and obligations of USRA might constitutionally be used as payment for the assets compelled to be transferred, with a cash award only for any "shortfall" between their value and the just compensation required by the Fifth Amendment, thus support the same conclusion with respect to the ConRail securities and CV's provided for in the amended Act not only as to the PC, the carrier before the Court in the *Rail Act Cases*, but as to all transferors, both bankrupts and nonbankrupts. Indeed, we would reach this conclusion independently. As the Court observed, 419 U.S. at 150:

> No decision of this Court holds that compensation other than money is an inadequate form of compensation under eminent domain statutes.

The one federal case and the state cases cited by some transferors as so holding are not impressive. Most of them were decided many years ago and evince attitudes reflective of an earlier stage in the development of the economy when compensating a condemnee in securities would force him to resort to an imperfect, discontinuous market to retrieve their value. In some, the state attempted to compensate the condemnee with land, *e.g.*, *Vanhorne's Lessee* v. *Dorrance*, 2 Dall. 304, 315-16 (Cir. Ct., Pa. Dist. 1795); *Groce* v. *Greenville, S. & A. Ry.*, 94 S.C. 199, 202, 78 S.E. 888, 889 (1913); *Reynolds* v. *State Board of Public Roads*, 59 R.I. 120, 194 A. 535 (1937); *Shurtleff* v. *Salt Lake City*, 96 Utah 21, 23, 82 P.2d 561, 562 (1938), or by affording

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In our view this reliance is misplaced. The court of appeals had previously noted that, "The jurisdiction of the federal district courts sitting in bankruptcy is limited to matters conferred by statute expressly or impliedly." *Id.* at 880. The finding that no such jurisdiction over the fee interest in defendant's property had been conferred compelled the conclusion that the district court could not constitutionally order the conveyance, since no court may constitutionally act beyond its jurisdiction. Here, there is no doubt that the Rail Act confers jurisdiction over the property of a nonbankrupt lessor. If the court of appeals meant more than what we think it did, we would be constrained to disagree.

the right to use the same or other property taken, *e.g.*, *State* v. *Smith*, 25 Wash.2d 520, 544-45, 171 P.2d 853, 855 (1946). Other cases were decided under state constitutional provisions which expressly or impliedly required compensation to be paid in money, *e.g.*, *Martin* v. *Tyler*, 4 N.D. 278, 292-93, 60 N.W. 392, 397 (1894); *Gardiner* v. *Henderson*, 103 Ariz. 420, 424-25, 443 P.2d 416, 420-21 (1968) and thus have no relevance to an interpretation of the just compensation clause of the Fifth Amendment.

We shall not attempt to discuss in detail all of the decisions the transferors have cited. We note only that the transferors would have us mechanically apply the rulings of these cases while ignoring their underlying rationale—that the compensation required by the Fifth Amendment must be sure and certain and equivalent in value to the property taken. The payment scheme of the Rail Act complies with that requirement. The CV's "constitute general obligations of the United States of America for the payment or redemption of which its full faith and credit are pledged." § 306(a). The value of such a certificate, carrying 8% interest and redeemable not later than December 31, 1987, § 306(c)(1), can readily be computed by reference to other Government obligations for which a wide market exists. The method for determining the market value of the ConRail securities, which is to be deducted in fixing the base value of the CV's § 306(c)(5), accords with commercial practice; while there is some risk that these securities may be overvalued, there is equal risk that they may be undervalued. Experience has taught us that cash itself may fluctuate in value. Application of the Rail Act, with supplementary resort to the Tucker Act if needed, will afford the transferors "a full and perfect equivalent of the property taken," *Monongahela Navigation Co.* v. *United States*, 148 U.S. 312, 326 (1893). The Constitution requires no more.

Appendix E

III. *Net Liquidation Value (NLV)*

We deal in this section with a variety of questions relating to the determination of net liquidation value under § 306 of the Act relating to the certificates of value (CV's). It is well to emphasize that these are questions of statutory construction, not of constitutionality; we will consider the constitutional questions in Part IV.

(1) *DOT's contention that NLV is limited to scrap value*

We begin with the contention of the Department of Transportation (DOT) that the only kind of liquidation contemplated by Congress for the purpose of fixing the face value of the CV's would be a liquidation for scrap. The principal basis for this claim is that when Congress adopted the amended Act in 1976, the only theory of liquidation value which was before it was the discussion in the *New Haven Inclusion Cases*, 399 U.S. 392 (1970), which DOT argues proceeded on a scrap value theory. This is an insufficient basis for so restrictive a reading in the absence of any expression by Congress that it meant us to fix NLV on that basis alone. "Liquidation," as used in common speech, connotes all available methods of disposition, including but not limited to disposition for junk.[10] Moreover, the Supreme Court's *New Haven* opinion did not proceed exclusively on a scrap value theory. In its discussion of the Bronx freight yards, the Court found that trackage and electrical facilities in the yard would not have been dismantled, but rather maintained for continued rail use. "It is not rational," the Court stated, "to suppose that the managers of the hypothetical liquidation sale, devoted to obtaining the highest possible price for the assets of the debtor,

10. *Ballantine's Law Dictionary* 743 (3 ed. 1969) broadly defines liquidation as "the winding up of a corporation, partnership, or other business enterprise by converting the assets to money, collecting accounts receivable, paying debts, and distributing the net proceeds, if any among the shareholders, partners, or owners of the business." *Webster's New International Dictionary* 1441 (2 ed. 1960) adopts a similarly general definition, "To convert into cash by selling."

would have ignored the best use of the yard facilities and stripped them of more than $4,000,000 in value." 399 U.S. at 456-57 (footnote omitted). Congress was told in the FSP, Vol. I, at 125, that the Master Liquidation Plan (MLP) assumed "that the estates would be required to sell substantial assets for continued rail use" and that "the liquidation plan postulated by USRA is for an orderly transfer of the transportation services to other railroads. . . ." While the FSP added that "the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses," *id.*, and that the prices of transfers to other railroads would be "computed as if the estates had actually been allowed to exercise their asserted rights to liquidate by selling all their assets for non-rail uses," *id.*, the FSP furnished no explanation for this strange assumption, and there is no indication that Congress endorsed it.

(2) *The transferor's contention that for purposes of determining NLV, the United States may be regarded as a purchaser*

At the other extreme, we likewise reject the contention of the Trustees of the Penn Central that the directive in § 306(c)(4) that net liquidation value be "determined by the special court" gives us free rein to incorporate into NLV our guess as to what the United States would have paid for the properties if the Rail Act had not been enacted.[11] We here rely in considerable measure on the legislative history of § 306, reviewed in Part V of our Opinion of October 18, 1976, 425 F. Supp. at 274-75.

First, the House Report on the 1976 Amendments stated that the Committee concurred with USRA's general approach toward valuation, H. R. Rep. No. 94-725, 94 Cong., 1 Sess. 90 (1975), and intimated that this Court should be guided, although it would not be bound, by that approach:

11. The Lehigh Valley Trustee apparently concedes that NLV does not encompass potential sales to the Government. Brief at 6-9.

> While the Committee finds persuasive the Association's particular methodology in arriving at its estimates of net liquidation values, it also recognizes that these determinations must be left to ultimate judicial review and determination.

Id. Although as indicated in the previous section of this opinion, Congress cannot be supposed to have endorsed every statement in the FSP's analysis how NLV would be determined, it surely did not mean us to depart so far from the Association's "particular methodology" as to regard the Government as a prospective purchaser and to guess what it would have paid. As noted above, the FSP stated, "In essence, then, the liquidation plan postulated by USRA is for an orderly transfer of the transportation services provided by the estates *to other railroads*. . . ." Vol. I, at 125 (emphasis added).

Second, we may look to the *New Haven Inclusion Cases* as some evidence of the type of liquidation Congress had in mind for purposes of determining NLV.[12] While, as we have noted, that decision does not support the notion that only scrap value can be considered in determining NLV, it contains no hint that the Federal Government could have been considered as a potential purchaser of the New Haven's assets.

Beyond all this, whatever may be the proper characterization of the role which Congress intended for the United States under the Rail Act, it was certainly not that of a "willing buyer." It

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12. Indeed, Congressman Rooney, chairman of the House subcommittee that considered the 1976 amendments, stated on the floor of the House:

> Underwriting all of the provisions of the transfer, this legislation authorizes "certificates of value," which are financial instruments, to guarantee the creditors the net liquidation value of their assets if the new corporation fails. It is this net liquidation value that the Supreme Court in the New Haven case determined was the value of a bankrupt railroad.

121 Cong. Rec. H12754 (daily ed. Dec. 17, 1975).

would thus be impermissible, as a matter of statutory construction, to take account in fixing NLV of the possibility, probability or, as the transferors would have it, certainty that, failing the Rail Act, the United States would have been obliged to make other arrangements for continued rail service. This would be true even if we were required to take account of that factor in fixing CMV. However, as will be shown in Part IV of this opinion, we are not required or even permitted to determine CMV in this manner. Congress created the CV's to afford a bridge, partial or total, between the value of the ConRail securities and CMV—not to constitute part of a bundle that might exceed CMV, with the consequent need for corrective action by this court under § 303(c)(3).[13] *See* H.R. Rep. No. 94-725, *supra* at 90 ("[T]he Committee believes that the certificates of value will assure to each transferor consideration equal to the requirements of a constitutional minimum.").

(3) *The contention of the Government parties that, for purposes of determining NLV, potential sales to other government bodies must be disregarded*

This leads us to the renewed contention of the Government parties that in determining NLV, and for that matter CMV, potential sales to other governmental bodies may not properly be taken into account. Just as we see no reason why sales to other railroads for railroad use should be excluded from consideration in fixing NLV, as the Government parties other than DOT now concede, Brief at 72-74, we likewise see no basis for assuming that

13. Section 303(c)(3) provides in relevant part:

> If the special court finds that the terms of one or more conveyances or exchanges for securities, certificates of value or other benefits are fairer and more equitable than is required as a constitutional minimum, then it shall order the return of any excess securities, certificates of value, or compensation to the Corporation or a profitable railroad, State, or responsible person so as not to exceed the constitutional minimum standard of fairness and equity.

when Congress spoke of liquidation it meant to exclude sales to public bodies. It must have been known to Congress that there had been such sales, particularly of commuting lines, and there was every reason to suppose that in the event of such a catastrophe as a general cessation of railway service in the Northeast, states and municipalities would at least endeavor to salvage the lines on which hundreds of thousands of citizens traveled to and from work in the cities. Indeed, other sections of the Rail Act reflect Congressional recognition of the active role state and local governments would assume in ensuring continued rail service. Section 304(c)(2)(C) of the Act provides that rail service may not be discontinued if a financially responsible person "including a government entity," offers to purchase the rail properties in order to continue service. Section 403 provides for federal loans to enable state and local governments to make such purchases. *See also New Haven Inclusion Cases, supra,* 399 U.S. at 450 n.66 (citing Penn Central negotiations with Connecticut and New York for state takeover of New Haven commuter services).

Of course, if the Government parties were right in their contention that prices payable by public bodies cannot be taken into account in determining CMV, this would argue against taking the possibility of such sales into account in determining NLV, for reasons similar to those on which we partially relied in rejecting the notion that NLV could take account of a possible sale to the United States. However, for reasons developed in Part IV of this opinion, we largely reject that contention.

(4) *The method for determining scrap value*

As already indicated, although the Government parties other than DOT concede that the transferors are entitled to attempt to prove NLV based on sale of part or all of their property to profitable railroads, the only figures presented to Congress in the FSP contemplated sale for scrap in accordance with the MLP. Vol. I, at 124-26. This plan was more fully described in a report dated March 1, 1976. The report disclosed, as FSP had already

done in some degree, Vol. I, at 145-46, that one of MLP's assumptions was that a considerable amount of time after the conveyances would be consumed in obtaining regulatory approvals.[14] Recognizing that the time required in fact would unpredictably differ with the nature of the trackage, the Report assumed a uniform date of January 1, 1979 for the commencement of the winddown.[15]

At the oral argument in April, 1977, counsel for the Government parties advised the court that they no longer considered valid the assumption of a three year delay before the sale program could begin and that they were developing an alternative approach. In response to the court's request that the Government parties promptly inform it and the other parties of significant changes contemplated in MLP, the Government parties filed a statement on July 5, 1977. MLP will now eliminate any assumption that any time after April 1, 1976 would have to be spent in securing abandonment authority.[16]

14. Specifically, the Report assumed that the railroads could only commence liquidation pursuant to orderly plans that would minimize the impact on the economy, that judicial and regulatory approval of such plans would take from two to nine years, that ICC approval for trackage abandonments would take up to 10 years, and that the time required for orderly transition of services to other railroads and modes of transportation, "a critical factor affecting the willingness of the judicial and regulatory authorities to let liquidation commence," would be 7-10 years. *See* Selected Inputs to Valuation Analysis, I-1 to I-14, in *Valuation Reports of Properties Subject to the Regional Rail Reorganization Act of 1973* (1976).

15. Winddown is defined as "a period of intense activity associated with the promulgation of freight and passenger embargo notices and the preparation for ending railroad operations." *See* Master Liquidation Plan and Summary of Valuation Reports, at 7-10, in *Valuation Reports, supra.* The period lasts 90 days, followed by a 180 day period, commencing April 1, 1979, for consolidation of inventories of rolling stock, materials and supplies, and other nonfixed assets. Sales of rolling stock would begin on April 1, 1979, and sales of dismantled facilities on July 1, 1979, continuing for a considerable time thereafter.

16. This concession is due to the fact that MLP, now styled the "retrieval model," assumes the existence of the Rail Act. Since the compelled conveyances constituted a maturation of the carriers' "*Brooks Scanlon* rights," *see* 180-Day Appeals, 384 F. Supp. at 918-20; CUE opinion, pp. 27, 37, the Government parties no longer insist on

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The parties appear to agree that most issues concerning the methodology of the MLP are not yet ripe for decision—a rather obvious conclusion since MLP is still evolving. However, the Government parties have asked us to uphold the validity of the model for purposes both of NLV and CMV insofar as it presupposes a coordinated method of withdrawal. In contrast, the transferors seemingly invite us to rule that the model is invalid on precisely this account, since the scrapping of one railroad, particularly if PC were the one, might avoid any need for scrapping others. We decline both invitations.

The Government parties stress that what they term the "retrieval model" embodied in the MLP assumes the presence of the Rail Act and apparently argue that this requires a hypothesis of simultaneous withdrawal. It is surely true that the Rail Act compelled the operation of all the roads until April 1, 1976 and the cessation on that date of operations over the mileage that was

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assuming the need for further regulatory approvals for scrapping the properties—although they continue to insist that regulatory delays after April 1, 1976 must be taken into account in any "alternative scenario" which involves sale of part or all of the properties for rail use and, if only part were so sold, for the scrapping of the rest. While it might seem that this changed assumption would substantially increase the scrap value figure, since the reports assumed a pre-tax discount rate of 13% for property other than real estate and 16% for real estate, much of the bloom is taken off the rose by the following qualification (p. 10):

> The Government Parties' conclusion that, for retrieval model purposes, the transferors must be deemed to have certificates of abandonment in hand on April 1, 1976, does not undermine the validity of the concept of using a computational proxy to model a multidate process. The validity of any particular proxy date depends, of course, upon (a) the nature of the gradual process for which the proxy substitutes, and (b) a fair valuation equivalence between the present value of the net proceeds produced by the gradual process and that produced by use of the proxy date. USRA has commissioned a study to determine an appropriate proxy date in light of the elimination of any pre-availability delay after March 31, 1976, attributable to the need for abandonment approvals, as well as possible changes in USRA's valuation of particular asset categories. Preliminary results of the study suggest that the new proxy date may be earlier than January 1, 1979.

transferred, with a consequent fulfillment of *"Brooks-Scanlon* rights" at that tie. But, as developed in our CUE opinion, p. 35, the railroads were constitutionally entitled to cease operations after a reasonable period for securing abandonment authority on applications which (save in the case of EL) would have been filed in early 1973 but for the discussions leading up to the Rail Act. Since the Rail Act foreclosed this right, each transferor must be allowed to prove, if it can, that exercise of this right, even in the form of a sale for scrap, would have yielded more than MLP.

A transferor cannot, of course, realistically assume that it would have been operating in a world where it was the only railroad engaged in a liquidation for scrap. If it presents a plan which does not appropriately allow for this, the Government parties can object on that account. By the same token, we see no reason why the Government should not be permitted to come forward with figures based on MLP, as it may be revised, since at the least this shows what one possible method of disposition for scrap would have been. What is important is that the transferors should now make known what they intend to advance as their scrap liquidation plans, so that the Government parties will know what cases they will be obliged to meet. We direct that each transferor should serve and file such a plan not later than December 9, 1977.[17] While most of the revisions of MLP have been promised by this fall, we are distressed that some (real estate valuations and a variety of other studies including the highly important subject of discount rates) will not be ready until 1978. We direct that the Government parties make every effort to expedite this work.

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17. If the transferors would prefer a course whereby they would seek to coordinate their scrap liquidation plans before disclosing them to the Government parties and the court, similar to what we later direct in connection with sales for rail use, *infra*, p. 30, we will entertain a proposal to modify the above direction accordingly. So also if the transferors should elect to forego the submission of any plans calling for a solely scrap liquidation and to integrate scrap sales with sales for railroad use.

(5) *The method for determining values attainable on sales for railroad use*

The Government parties concede (Brief at 74) that:

> Any transferor is entitled to attempt to show that it had (before the Rail Act was passed) and would have exercised (had the Rail Act not been enacted) a right to take some specific course of action to realize rail use values from its properties.

However, the Government parties insist, *id.*, that any endeavor on the part of transferors to show that such a course would have produced values exceeding the sale of their properties for scrap must conform to an "alternative scenario." They say this must meet four criteria: "(1) consistency, (2) feasibility, (3) legality, and (4) the assumed absence of the Rail Act or any other new governmental action designed to keep the rail properties indefinitely in operation." (Govt. brief at 77). Application of the last of these criteria would, in practical effect, make presentation of an alternative scenario impossible since, as appears from our CUE opinion, pp. 41, 54 nn.59 & 60, 61, many transferors claim they would have reached the point of cashlessness in early 1974 and Erie Lackawana (EL) claims it would have reached this point in the winter of 1975 absent the emergency assistance provided by the Rail Act.

At oral argument Government counsel relented in some important respects from the rigidity of the position taken in brief. The Government indicated that it would not demand proof that the transferors had received actual offers at identifiable prices. This might well be difficult to show in view of the fact that once serious discussion of what was to become the Rail Act began in the winter of 1973, profitable railroads had little incentive to conduct discussions directly with the various reorganization trustees. Hence it would be enough to show that, in the phrase used by counsel for EL at oral argument, profitable railroads should in their "own self

interest" have wished to purchase various lines of the transferors. On the point mentioned at the end of the preceding paragraph, the Government parties also conceded that an alternative scenario might legitimately assume that the Government would have provided emergency assistance in some form for a reasonable period "to permit adequate ICC review of the abandonments or transfer applications," Transcript at 296, and to avoid liquidation "in chaos," Transcript at 283. Furthermore, counsel for the Government parties did not exclude the idea that the alternative scenario could take account of possible regulatory reforms, including those made by the Railroad Revitalization and Regulatory Reform Act of 1976, which would have made purchases more attractive.

We believe these concessions were well advised; indeed they may not constitute the limit. If the Rail Act had not been passed, Congress still would have had powerful incentives to attempt to preserve at least some of the rail transportation previously furnished by the bankrupt entities in the Northeast and to make reasonable funds available to the reorganization trustees while studies were being prepared and negotiations with other railroads were proceeding; the parties will doubtless differ whether these would have been loans or grants. Although the Government parties may well be right in saying that the transferors cannot legitimately hypothesize that Congress would have done more in the way of interim financial aid to keep the bankrupt estates alive pending negotiations with other railroads than it did in the Rail Act pending the development and consummation of the FSP, the Government equally cannot sustain the proposition that Congress would simply have sat by and done nothing.

However, the Government parties have not receded from their most basic position relating to the alternative scenario, namely, the requirement of consistency. For example, they would insist, with reason, that it would be improper to fix NLV or CMV on the basis that a number of transferors would have been able to sell lines connecting the same points to a single profitable railroad

when that railroad would have wished only one, or to assume that a particular line would have substantial traffic because a parallel line was being dismantled and then to make the same assumption in valuing the parallel line. From this premise, the Government parties go on to insist (Brief at 81) that "all transferors seeking to show rail use values for particular lines should be required to set forth explicitly their underlying assumptions about all other lines whose dispositions would bear on their properties' value." As a practical matter, this would seem to require a joint presentation by all transferors proposing to offer evidence of higher values attainable by sales for rail use.

Such a course of action by the transferors would surely be desirable and, at the conclusion of the oral argument on April 13, we suggested that the transferors should not await the issuance of this opinion but should begin conversations among themselves with a view to seeing whether a unified alternative scenario could be developed and to report to us if any progress along these lines had been achieved. We have received no report as to what, if anything, has been done. While we believe that, as in the case of sales for scrap value, each transferor is entitled to make its own proffer as to what it would and could have done by way of sales for rail use, the Government parties are right in saying that a most difficult problem will be presented if transferors make basically inconsistent proposals. It is in everyone's interest that all reasonable efforts should be made to eliminate or at least to reduce these inconsistencies. We therefore direct that any transferor seeking to present evidence of values to be obtained by sales for rail use shall exchange its proposal with all other transferors not later than January 9, 1978; that the transferors shall then meet among themselves with a view to a maximum ironing out of inconsistencies; that they shall deliver their proffers, as these may be revised in the light of such discussions, to the Government parties on a date not later than March 9, 1978; that the Government parties shall indicate any objections on the score of inconsistency within another 30 days; and that finally revised proffers shall be filed

with this court not later than 30 days after the transferors' receipt of the Government's objections. We do not deem it practical at this time to specify the level of detail to be contained in such proffers, beyond saying that they should be sufficiently particularized to be meaningful.

We also agree with the Government parties that the proffers of sale for railroad use must meet the criterion of legality. In saying this, however, we would not wish to be understood as ruling that the transferors must carry the burden of showing that the proposed transactions would have been approved by the Interstate Commerce Commission under criteria which the ICC had evolved in dealing with sales of profitable railroads. The Commission would have been confronted with a situation quite unlike those with which it had been presented in previous merger cases. Just as the antitrust laws have received a different application in the case of the acquisition of a failing business, *International Shoe Co.* v. *FTC*, 280 U.S. 291, 301-02 (1930); *Citizen Publishing Co.* v. *United States*, 394 U.S. 131, 136-38 (1968); Department of Justice Merger Guidelines ¶¶ 9, 15, 21 (1968), *reprinted as amended in* 1 Trade Reg. Reptr. [CCH] ¶ 4510, the Commission would have been permitted, indeed required, to apply different criteria, particularly as to the preservation of competition within the Northeast Region and of competitive balance outside it, when it was confronted with a situation where the alternative to some sort of approval would have been the cessation of substantially all railroad operations in the Northeast. There is also the possibility that if the Commission showed signs of an undue tendency to proceed along traditional lines, Congress might have stepped in. Thus, we do not at all exclude such possibilities as joint action by the transferors in the Northeast Region or joint purchases by profitable railroads to the west and south which ordinarily might have been deemed objectionable under the antitrust laws.

Finally, we record our disagreement with the suggestion of the Government parties that the Interstate Commerce Commission

would or could have used its power to withhold approval so as to insist on the inclusion of unprofitable mileage to a degree that would have driven down the price that purchasers would pay to the level of scrap value, a view which now appears to have been the basis for the extracts from FSP, Vol. I, at 125, cited above, p. 19.[18] We do not intimate that the Commission would have had no alternatives other than complete acceptance or rejection of the proposals as made. On the other hand, the suggestion that the Commission would or legally could have required purchasers to take on more and more unprofitable mileage on the basis that no harm was being done to the transferors so long as the purchase price was no less than scrap value appears to us to be unsupported by authority[19] and in effect to negate the concession that sales for

18. We rejected an argument that was a variation on this theme in the October 18 opinion, 425 F. Supp. at 271-73.

19. In one of the cases cited, *Jamestown, W. & N. R.R. Abandonment*, 217 I.C.C. 739 (1937), the Commission refused to approve the sale of certain terminal properties to the Erie Railroad on a condition that would have required the Jamestown actually to abandon 31 miles of mainline track and thus deprive the city of Jamestown of railroad connections with three other competing carriers. When the Erie withdrew the condition, the Commission approved the sale without any effort to force the Erie to acquire and operate the track. *Erie R.R. Trustees' Purchase*, 244 I.C.C. 13 (1941). In another case, *Abandonment of Part of Line by Gulf Ports Terminal Ry.*, 111 I.C.C. 597 (1926), the ICC merely required the abandoning railroad to accept any offer by a purchaser willing to continue all the properties in rail use that would *match* the highest offer received from a buyer which planned to operate some properties and dispose of the rest for nonrail use. The Commission did not speak of a prospective buyer which would be forced to operate properties it did not wish to operate.

Cases cited by the Government parties for the general proposition that conditions may be attached to an abandonment, *ICC* v. *Railway Labor Exec. Ass'n*, 315 U.S. 373 (1942); *Reed* v. *Meserve*, 487 F.2d 646 (1 Cir. 1973), and ICC decisions specifically conditioning abandonment on the imposition of labor protective measures, *Chicago, B. & Q. R.R. Abandonment*, 257 I.C.C. 700 (1944); *Fort Dodge, D.M. & S. Ry. Abandonment*, 312 I.C.C. 708 (1963), *off'd, Humphreys* v. *United States*, 228 F. Supp. 910 (N.D. Cal. 1964); *East Carolina Ry. Abandonment*, 324 I.C.C. 506 (1964); *Missouri-Kansas-Texas R.R. Abandonment*, 328 I.C.C. 728 (1971); *Penndel Co. Abandonment*, 342 I.C.C. 570 (1973), furnish no authority for the position of the Government parties. Nor do § 5(2) of the Interstate Commerce Act, or cases

continued rail use would have been a permissible, indeed the preferred, form of liquidation.

IV. *Constitutional Minimum Value (CMV)*

The basic position of the Government parties is that CMV is the market value of rights of which the transferors were deprived by the Rail Act. These would include (1) the right to use their properties for a profit and (2) the right to sell the properties for continued rail use by others or, failing this, for scrap.[20] While conceding the existence of (1) in principle, the Government parties consider it to be largely if not wholly theoretical on the

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decided thereunder, *e.g.*, *New York Central Securities Corp.* v. *United States*, 287 U.S. 12, 28 (1932); *Thompson* v. *Texas Mex. Ry.*, 328 U.S. 134, 149-50 (1946); *Penn Central Merger Cases*, 389 U.S. 486, 495-96 (1968), furnish analogical support for the proposition that the ICC can require a prospective buyer to operate properties it did not not wish to and could not economically operate. Section 5(2) by its terms authorizes inclusion only of "another railroad" in a merger, and then only upon petition of that railroad. 49 U.S.C. § 5(2)(d). The section thus authorizes inclusion where a separate, third-party railroad seeks to participate in a merger transaction initiated by others; we have been cited no authority that, if some of the third party's lines were profitable and others were not, the Commission could insist that hopelessly unprofitable lines must continue to be operated and reduce the price payable to the third party to reflect this. Indeed, the portion of the Supreme Court's *New Haven* decision relating to the Bronx freight yards, p. 19 *supra*, indicates the contrary.

20. The presentation of the Government parties has been complicated by persistent argument on what they call "ConRail use value." The point of this is that under the Rail Act the transferors receive all the junior securities of ConRail, so that whatever earning power ConRail possesses after payment of the charges on its debt and Series A preferred stock (or payment and redemption thereof) will belong to the transferors. While this is true for the properties transferred to ConRail taken as a whole, there may be lines which could now be operated at a profit, and some which after rehabilitation might attain that state sooner than others. Furthermore, the argument has no application to properties conveyed to persons other than ConRail, for which no ConRail securities are issuable. We thus fail to see that "ConRail use value" has great significance except as a shorthand way of stating that the conveyances compelled by the Rail Act differ from those usual in condemnation in that the transferors do retain upside potential if the properties should turn out to have earning power not reflected in the value of the ConRail junior securities at the redemption date of the CV's.

submissions that have been made to date, since nearly all transferors have asserted, notably in their briefs on CUE, that their properties were hopelessly losing and were destined to remain so.[21] As already indicated in Part III, the Government parties further submit that scrap value should be determined in accordance with a Master Liquidation Plan (MLP) and insist that proposals in regard to sale for rail use should conform to a single "Alternative Scenario."

While the transferors attack the MLP and the demand for a single Alternative Scenario on the grounds indicated in Part III of this opinion and others, their major contention with respect to CMV is that the entire approach of the Government parties is wrong. Pointing to numerous declarations of members of the executive and legislative branches during the consideration of the Rail Act and to recitals in the Preliminary System Plan[22] they

21. The Government parties other than the DOT further suggest that as a practical matter any value in possible retention for rail use by a particular transferor would be reflected in value for sale to others for rail use. This is not necessarily true since while capitalized earning power would be what a seller would ask, it is not inevitably what a buyer would pay. The small number of prospective buyers, pressure on the seller to dispose of the property, and discrepancies in the information possessed by the parties to the transaction are some of the factors that would make the Government parties' "perfect market" outcome unlikely.

22. The House Committee Report on the Rail Act observed that

> The services [that the bankrupt carriers] perform are essential to the nation, and the blow to the economy if such services were interrupted only briefly, would be devastating. This is a matter which affects not only the economy, but also the defense needs of the nation.

H.R. Rep. No. 93-620, 93d Cong., 1st Sess. 28 (1973). The Senate Report was equally apocalyptic:

> [The carriers'] services are not only essential to the prosperity and well-being of the people and industry in the Northeast and Midwest, but they are essential to the well-being and prosperity of the Nation as a whole. Cessation of services on the Penn Central alone would have drastic consequences throughout the United States. For example, it has been predicted that a shutdown of the Penn Central would produce a decrease in the rate of economic activity in the region of 5.2%, a decrease in the entire

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assert that even a temporary, let alone a permanent, cessation of their operations would have caused such economic and environmental problems as to be unthinkable. They say that the value of properties which have this crucial importance to the nation but which can no longer be operated at a profit, at least in part because of national and local regulatory and promotional policies and demands, cannot be limited to what could be obtained by way of sale to private or even other public bodies. They therefore urge that, in fixing CMV, we must "consider," with what weighting is not altogether clear, many factors other than the market value of the rights of which the transferors have been deprived. These include such concepts as gross liquidation value, original cost less depreciation, trended original cost less depreciation, reproduction cost less (or even without) depreciation, assemblage value, the value of "externalities," and "societal value." In an attempt to conform these concepts more nearly to the conventional wisdom that property being condemned is generally to be valued on the basis of what a willing buyer would pay a willing seller, the reply brief of the PC Trustees envisions a bargaining process in which the buyer would begin by offering an amount equal to value for continued rail use for some properties and scrap value for others,

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Nation of 4%, and a decrease in GNP for the Nation as a whole of 2.7% after the eighth week of such a shut-down.

S. Rep. No. 93-601, 93d Cong., 1st Sess. 7-8 (1973). The Senate Report concluded that the "entire economy of the United States would suffer drastically if the railroads in the Northeast and the Midwest shut down operations." *Id.* at 8. *See also* Hearings on Northeast Rail Transportation Before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 93d Cong., 1st Sess., pt. 1, at 219 (statement of Claude Brinegar, Secretary of Transportation); 621-23 (policy statement of the New England Governors' Conference); Hearings on S. 281 Before the Surface Transp. Subcomm. of the Senate Comm. on Commerce 94th Cong., 1st Sess. 1 (1975).

Section 101(a) of the Rail Act reaffirmed this determination of the essentiality of the Northeast rail system. The Preliminary System Plan, as well, recognized the "devastating implications for the regional and national economy" of shifting freight to other modes of transportation. Vol. I, at 139.

knowing that the seller would not take less, and the seller would begin by demanding reproduction cost less depreciation, knowing that the buyer would not pay more, and bargaining would then ensue.[23] This has the further effect of bringing CMV in line with NLV and thereby avoiding the need for proceedings in the Court of Claims.

Before going further it is useful to comment on what seems to us to be a difference in the concept of "property" held by the Government parties on the one hand and certain transferors on the other. Some transferors challenge the Government parties' valuation theory at a fundamental level by arguing that what was taken, and what must be valued , is "property," not "rights" to use or sell or, in a favorite phrase of the Government, "foreclosed options." If they mean by this that the Government's "foreclosed option" approach is only a valuation standard rather than a description of what was taken and that we should begin our valuation analysis on the premise that "property" rather than certain "rights" were taken,[24] our answer is that the definition of what was taken is so closely related to the valuation question that the two cannot be treated separately, *see Bonbright, Valuation of Property* 99 (1937) (hereafter *Bonbright*); if the point is that "property" is something more or different than certain legally-protected rights,[25] and for this reason alone must be valued on some basis other than by consideration of the rights of which the transferors were deprived, we must disagree. For "property" is nothing more than a collection of rights and can be valued on no other basis; talk of property as having some reified existence simply makes for confusion. *See Ackerman, Private Property and the Constitution* 26-27, 201-03 (1977), and numerous sources cited therein; 2 *Nichols, Eminent Domain* § 5.1[1], at 5-

23. A similar proposal had been presented in the Opening Brief of the NH Trustee. Brief at 59-73.

24. As the PC Trustees at one point apparently do. *See* Reply brief at 20-21.

25. *See* PC reply brief at 16-20; CNJ reply brief at 17-18; LV reply brief at 12-13.

8 to 5-10 (3d ed. 1976); Cohen, *Property and Sovereignty*, 13 *Cornell L.Q.* 8, 11-12 (1927); *cf. Bonbright* at 100-08. As Mr. Justice Roberts said for the Court in *United States* v. *General Motors Corp.*, 323 U.S. 373, 377-78 (1945), a condemnation case:

> It is conceivable that the [term "property" in the just compensation clause] was used in its vulgar and untechnical sense of the physical thing with respect to which the citizen exercises rights recognized by law. On the other hand, it may have been employed in a more accurate sense to denote the group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use and dispose of it. In point of fact, the construction given the phrase has been the latter.

(Footnote omitted).[26] *See also United States* v. *Chandler-Dunbar Water Power Co.*, 229 U.S. 53, 81 (1913), and *Boom Co.* v. *Patterson*, 98 U.S. 403, 408 (1878).

26. Although this was said in a case involving the taking of a portion of a lease, so that it was necessary to abandon a "vulgar and untechnical" view of property as a "physical thing" in order even to find that there had been a taking of property, the Court's analysis in *General Motors* does not become inapposite in a case where the taking involves a more concrete property interest. As Mr. Justice Holmes once noted, "Ordinarily an unqualified taking in fee by eminent domain takes all the interests and as it takes the *res* is not called upon to specify the interests that happen to exist." *A.W. Duckett & Co., Inc.* v. *United States*, 266 U.S. 149, 151 (1924). Similarly, it is not surprising that courts refer explicitly to the "bundle of rights" theory of property largely when the taking is of something less than all the rights relating to the thing itself, for it is in those cases that judges are forced to clarify basic conceptions of property. *See, e.g., Town of Bedford* v. *United States*, 23 F.2d 453, 454 (1 Cir. 1927); *United States* v. *53¼ Acres of Land*, 139 F.2d 244, 247 (2 Cir. 1943), *cert. denied*, 322 U.S. 730 (1944); *Adaman Mutual Water Co.*, v. *United States*, 278 F.2d 842, 846 (9 Cir. 1960); *United States* v. *Certain Land*, 220 F. Supp. 696, 699-700 (D. Maine 1963). *See also United States* v. *Causby*, 328 U.S. 256, 261-62 (1946), where the Court reasoned that there would be a taking of property if overflights rendered the land uninhabitable since "[t]he owner's right to possess and exploit the land—that is to say, his beneficial ownership of it—would be destroyed."

Some of the transferors argue for a constitutional minimum value in excess of what could have been obtained by sale to private entities or governmental bodies other than the United States on the basis that the United States should be included in the market, while others argue that in the peculiar circumstances of this case the ordinary willing seller-willing buyer approach is simply inappropriate.

In answering the first contention, the Government parties naturally emphasize Mr. Justice Holmes' famous aphorism in *Boston Chamber of Commerce* v. *City of Boston,* 217 U.S. 189, 195 (1910), "[T]he question is what has the owner lost not what has the taker gained." That statement alone, when read in context, does not greatly aid the Government parties since it was made in rejecting a claim that the owner of land being taken by Boston for use as a street and the owner of an easement of access could aggregate their interests so as to produce a larger value than if the city took the respective rights of each.[27] However, this was not to be the Court's last word on the subject.[28] In *McGovern* v. *New York,* 229 U.S. 363, 371-72 (1913), the New York courts had upheld the exclusion of evidence to prove the enhanced value of the land taken as part of a natural reservoir site and also the "fair and reasonable value of the Ashokan reservoir site which the city is condemning," of which the land taken was a part. In affirming, Mr. Justice Holmes said:

> It is conceded 'that the owner is not permitted to take advantage of the necessities of the condemning party,' and it would seem that it might well be that the commissioners

27. As pointed out in *Orgel, Valuation Under Eminent Domain* § 88 (2d ed. 1953) at 365 (hereafter *Orgel*), it is not clear what the relevance of the value to the taker point was in the case, since the land was worth the same to the city regardless of whether the owners' claims were aggregated.

28. We omit discussion of *United States* v. *Chandler-Dunbar Co.* *supra,* 229 U.S. 53, because of the many conflicting inferences that can be drawn from the opinion. See the discussion in *Orgel* § 88 at 365-70; *see also* Note, *Valuation of ConRail Under the Fifth Amendment,* 90 *Harv. L. Rev.* 596, 600 n.20 (1977).

> regarded it as too plain to be shaken by evidence, on the public facts, that the value of the land for a reservoir site could not come into consideration except upon the hypothesis that the City of New York could not get along without it and that its only means of acquisition was voluntary sale by owners aware of the necessity and intending to make from it the most they could. *It is just this advantage that a taking by eminent domain excludes.* (Emphasis supplied).

The italicized statement is not inconsistent with remarks in *McGovern* and other cases, *City of New York* v. *Sage,* 239 U.S. 57, 61 (1915); *Olson* v. *United States,* 292 U.S. 246, 256 (1933); *United States ex rel. TVA* v. *Powelson,* 319 U.S. 266, 275-76 (1943); *United States ex rel. TVA* v. *Powelson,* 138 F.2d 343 (4 Cir. 1943), *cert. denied,* 321 U.S. 773 (1944), upholding recognition of special suitability of the property taken for the governmental purpose if the owner had the ability to unite his land with other parcels essential to the project and the properties could have been put to the desired use without a taking by the particular condemnor.

In *United States* v. *Miller,* 317 U.S. 369, 375 (1943) (footnotes omitted), the Court made a statement having the same sweep as its earlier one in *McGovern:*

> Since the owner is to receive no more than indemnity for his loss, his award cannot be enhanced by any gain to the taker. Thus although the market value of the property is to be fixed with due consideration of all its available uses, its special value to the condemnor as distinguished from others who may or may not possess the power to condemn, must be excluded as an element of market value.

To be sure, the point covered by this statement was not in controversy. The issues were whether the owner should have "the benefit of any increment of value added to the property taken by

the action of the public authority in previously condemning adjacent lands," *id.*, to which the Court answered that he should, except for an increment "arising from the known fact that the lands probably would be condemned," *id.* at 377; and whether the lands in question "were so situated as to entitle respondents to the benefit of this increment," *id.* at 375, to which the Court answered that they were not. Still the holding that value arising solely from the prospect of condemnation must be excluded does seem to hinge on a premise that the taker must be excluded from the market.[29]

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29. An emphatic statement by a lower court to that effect in a case not dissimilar to ours is *United States* v. *Boston, Cape Cod & N.Y. Canal Co.*, 271 F. 877, 893 (1 Cir. 1921), where, in ruling out evidence of the military and naval value of the condemned canal to the United States, the court said:

> We are of the opinion that in ascertaining the market value of property taken in a condemnation proceeding the utility or availability of the property for the special purpose of the taker cannot be shown, if the taker is the only party who can use the property for that purpose. If, however, the property has a special utility or availability, not only to the taker, but to other parties who could use the property for the particular purpose intended by the taker, then this utility or availability may be shown.

See United States v. *Foster*, 131 F.2d 3, 6 (8 Cir. 1942), *cert. denied*, 318 U.S. 767 (1943) ("The value of the land taken to the party taking it is not the test but its value to the owner or the loss caused to him by its taking."): *United States* v. *Catlin*, 204 F.2d 661, 664-65 (7 Cir. 1953) (instruction that jury could not consider the government's use of the condemned land for an ordnance depot in valuing the property was proper). *See also United States* v. *46,672.96 Acres of Land*, 521 F.2d 13, 15-16 (10 Cir. 1975).

We see little relevance in *Grand River Dam Authority* v. *Grand Hydro*, 335 U.S. 359 (1948), since this was a contest between two parties both having the power of condemnation, and since the condemnation issues were decided under Oklahoma law. The Court held merely that the Federal Power Act did not prevent the state court from admitting evidence concerning the value of the property as a dam site, for which it was condemned. The Court stated explicitly, "[W]e express no opinion upon what would be the appropriate measure of value in a condemnation action brought by the United States or by one of its licensees in reliance upon rights derived under the Federal Power Act." *Id.* at 373.

The Government parties rely also on statements that the just compensation clause demands indemnification and nothing more. Thus the Court said in *United States* v. *Miller, supra,* 317 U.S. at 373:

> The owner is to be put in as good a position pecuniarily as he would have occupied if his property had not been taken.

and in *United States* v. *Reynolds,* 397 U.S. 14, 16 (1970):

> The owner is to be put in the same position monetarily as he would have occupied if his property had not been taken.

See Bauman v. *Ross,* 167 U.S. 548, 574 (1897); *Olson* v. *United States, supra,* 292 U.S. at 255; *Westchester County Park Comm'n* v. *United States,* 143 F.2d 688, 691 (2 Cir.), *cert. denied,* 323 U.S. 726 (1944). These statements gain added meaning when they are read in conjunction with Mr. Justice Frankfurter's opinion in *Kimball Laundry Co.* v. *United States,* 338 U.S. 1, 5 (1949):

> The value compensable under the Fifth Amendment, therefore, is only that value which is capable of transfer from owner to owner and thus in exchange for some equivalent. Its measure is the amount of that equivalent.

Here, if the "property had not been taken," the transferors would have had, at least so far as now known to us, hopelessly losing railroads, on the verge of "cashlessness." *See* p. 27, *supra.* The only value "capable of transfer from owner to owner" was the value obtainable by sale to private or governmental bodies other than the United States for continued rail use or by sale as scrap. The transferors answer that the United States had even greater compulsion to buy than other governmental bodies would have had and that, if we should sustain inclusion of the latter in the market, as subsequently we broadly do, there is no reason to exclude the former.

It appears to us, however, that inclusion of the taker in the market, in the sense of here attempting to reconstruct a bargaining process between the transferors and the United States, is inconsistent with the basic principle of eminent domain. While suitability of the property for a public purpose may properly be considered, this will not affect market value unless there is a prospective buyer other than the taker. It would be incongruous if the owner of an abandoned warehouse standing in the way of a contemplated highway or runway, who is relegated to market value if the building possesses some, were allowed the benefit of a hypothetical bargain with the taker because the structure had become so dilapidated as to have no market value at all. The essence of eminent domain is not only that it enables the condemnor to acquire property which the condemnee may not wish to sell but that it allows the condemnor to do this at a cost determinable in accordance with some external standard rather than by hypothesizing a bargaining process in which the condemnor's needs are an element and there is simply no way of determining the point where the bargain would ultimately be struck. *See also* Note, *supra,* 90 *Harv. L. Rev.* at 604. To reiterate Mr. Justice Holmes' statement in *McGovern, supra,* 229 U.S. at 372, "It is just this advantage [to the condemnee] that a taking by eminent domain excludes."

Thus, the usual meaning of the Fifth Amendment's just compensation clause is that the taker must pay the market value of the property, without considering its own presence in the market. In these circumstances, that rule would value each transferred property at the higher of scrap value or its sales value to parties other than the United States.

A. *Decisions Applying Rules Other than the Market Value Rule*

The transferors respond that, however we might view the matter if it were one of first impression, the decisions discussed up to this point have been qualified by others which have established that, in a case like this, a court must consider values beyond those

attainable in the market, notably reproduction cost or some variant upon it, whether on the theory of including the condemnor as part of the market or because market value is simply not an appropriate measure of just compensation. The transferors have advanced several lines of decisions to support this argument. We shall consider each of them:

(1) *Takings of property not held for profit*

The transferors refer us to federal cases such as *United States* v. *Certain Property,* 403 F.2d 800 (2 Cir. 1968), and numerous state court opinions, *e.g., Idaho-Western Railway Co.* v. *Columbia Conference of Evangelical Lutheran Augustana Synod,* 20 Idaho 568, 119 P. 60 (1911), *County of Cook* v. *City of Chicago,* 84 Ill. App. 2d 301, 228 N.E.2d 183 (App. Ct. 1967), *City of Wichita* v. *Unified School Dist. No. 259,* 201 Kan. 110, 439 P.2d 162 (Sup. Ct. 1968), *Newton Girl Scout Council, Inc.* v. *Massachusetts Turnpike Auth.,* 335 Mass. 189, 138 N.E.2d 769 (Sup. Jud. Ct. 1956), where a condemnor has taken property such as schools, churches, or parks not held for profitable use and the courts have allowed the owner to recover a sum sufficient to enable him to replace the property. *See* 4 *Nichols, supra,* § 12.32 [3][d]; Note, *Just Compensation and the Public Condemnee,* 75 *Yale L.J.* 1053 (1966); *see also Bonbright* at 419; 1 *Orgel* § 40, at 181-85. One can find in such cases statements like that in *Idaho-Western Railway Co., supra,* 20 Idaho at 583, 119 P. at 65:

> Whenever the property is of such character that it has no market value, its value for the uses and purposes to which it is being devoted and to which it is peculiarly adaptable may be shown. . . .

There are, as well, statements that appear to support the transferors' position that "[i]n such cases just compensation is arrived at by considering reproduction costs, replacement costs and other

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measures of value designed to approximate the true worth of the condemned property." PC Lienholders' reply brief at 20-21.

Whatever literal application such statements may have and, of course, the railroads here in question did possess *some* market value—the transferors' argument misses the true thrust of these decisions. The basic principle, as the Supreme Court said in the extracts from the *Miller* and *Reynolds* opinions quoted above, is that the owner is entitled to be put in as good a position as if the taking had not occurred. This means, in situations such as those here under discussion, being provided with the funds needed to build another school or church or to create another park.[30] In *United States* v. *564.54 Acres of Land*, 506 F.2d 796, 800 (3 Cir. 1974), the court stated:

> The community entity is entitled to be made whole, and making it whole means more than forcing it to abandon its non-profit community use and accept what it could obtain in the marketplace from a profit motivated purchaser. Simply stated this method insures that sufficient damages will be awarded to finance a replacement for the condemned facility. And since the owner of a facility devoted to a non-profit, public use has a proprietary as well as a community interest in it, if the fair market value exceeds the costs of the substitute facility, such an owner should be entitled to the higher of the two measures of compensation.

See also State of California v. *United States*, 395 F.2d 261, 264-66 (9 Cir. 1968).

30. Indeed, courts have limited application of this replacement cost standard to cases where replacement by the condemnee, whether public or private, is required by law or by the continuing needs of the community. *See, e.g., United States* v. *Certain Land*, 346 F.2d 690, 695-96 (2 Cir. 1965); *United States* v. *Certain Property*, 403 F.2d 800, 803-04 (2 Cir. 1968); *United States* v. *564.54 Acres of Land*, 506 F.2d 796, 800 (3 Cir. 1974); *United States* v. *Streets, Alleys & Public Ways*, 531 F.2d 882, 885-86 (8 Cir. 1976).

Here the transferors have no desire to be put in a financial position that will enable them to build another railroad; they want to exit from the railroad business, not to enter it. As the Supreme Court said in the *Rail Act Cases, supra,* 419 U.S. at 156,

> Complainants evidence no interest in retaining their property for longer than the Rail Act requires. Indeed, their position is really that they want to be free to dispose of it sooner. Thus, there is no interest asserted in retaining the properties themselves; the *only* interest is in making sure that creditors receive fair compensation for those properties.

In short, the notion of indemnity which is the root principle of the line of decisions here being reviewed is of no avail to the transferors in this case.

(2) *Use of reproduction cost to value a plant being used for a profitable purpose but unmarketable as such*

The transferors rely on the portion of *United States* v. *Certain Property Located in the Borough of Manhattan,* 306 F.2d 439, 445-49 (Foley Square) (2 Cir. 1962), relating to the newspaper *Il Progresso* as showing that when there is no market for property, reproduction cost may be used. Apart from the fact that the court ruled against the owner, not for him, the argument ignores the point central to the court's discussion. This was that *Il Progresso,* although operating in a 84 year old building and with rather outmoded machinery, was making a profit and wished to continue going on just as it had been. *See id.,* Appendix to Brief of Defendants-Appellants, at 1114a (District Court decision). Even so, the court sustained a zero award for the building on the basis of evidence that it had no value as a loft building and the absence of evidence that it had any more value as a printing plant. Evidence of reproduction cost of the machinery less depreciation was held to have been properly admitted as one way of getting at

the amount required to indemnify *Il Progresso*—by providing the funds it would need to start a similar operation elsewhere, 306 F.2d at 449. Here, as we have just seen, the transferors advance no such theory of indemnity. Unlike *Il Progresso,* they want to discontinue their business, not to continue it at a new site.

(3) *Cases where the market value of property is temporarily distorted or eliminated by governmental action*

Another group of cases said to require a departure from market value as a criterion in this proceeding concerns situations where market value has been adversely affected by governmental activity. The transferors claim that the Government's regulatory actions and its subsidization of other competing forms of transport bring them within the thrust of these decisions. It will be useful first to review the cases and then to consider their applicability.

Some of the cases concern compensation for property whose ordinary use and marketability were affected by wartime governmental regulation. In *United States* v. *Buxton Lines, Inc.,* 165 F.2d 993 (4 Cir. 1948), the federal government requisitioned a cargo ship with the idea of converting it to a troop transport vessel but returned the ship four months later when the conversion proved impractical. Rejecting the Government's claim that only a nominal amount was owed since the owner would not have been able to sell, charter or otherwise profit from the ship under wartime market conditions, the court ruled that just compensation must be set at "the sum which would probably be arrived at as the result of fair negotiations between an owner willing to sell and a purchaser willing to buy after due consideration of the elements affecting market value," adding that "[t]he purchaser willing to buy may be merely a hypothetical figure . . . as long as his absence is not attributable to the fact that the property has no value." *Id.* at 996. However, this holding was rested on the special fact that

> the [ship] could quite easily have been used during the period in question, the only difficulty being the absence of a private market as a consequence of the war and Government policies.

Id. Specifically, the condemnee offered evidence that the Government had prevented it from accepting a foreign company's lucrative offer to purchase the ship. *Id.* at 997. *Buxton* holds little more than that the Government cannot by order destroy a market, with buyers who would have been willing to pay high, perhaps even exorbitant, prices, and then say the property is worth nothing.

Swiss Federal Railways v. *United States,* 112 F. Supp. 357 (Ct. Cl. 1953), is a parallel case. The Court of Claims there rejected the Government's contention that just compensation for certain rail tires designed for use on Swiss track was scrap value in light of the absence of any other market at the time of taking in 1943. Although in fact it was the British blockade of shipments to Europe that prevented the tires from leaving New York, the court characterized the issue as if the United States' wartime regulation was responsible for the condemnee's inability to use or dispose of the tires. *See id.* at 361:

> Would anyone contend that the Government could take the completed or partially completed works of a fine watch that was ready to be fitted into the case and, on account of wartime conditions, forbid the sale of watches and pay for the watch on the basis of the limited value of the raw material that went into its production? Would anyone dare suggest that the Government could take a man's house and by forbidding the sale of houses or limiting the sale hold the value to the scrap value of the material that originally went into the house? If this were carried to its ultimate result the Government could requisition the arms and ammunition, the trucks and cars used in wartime, and pay for them on the basis of scrap material. It could make

> a regulation forbidding the sale of these articles in the general market and limit their sale to the Government itself. No one would even dare suggest that it would satisfy the requirements of the Fifth Amendment to offer to pay for them on the basis of scrap material. Yet that is the ultimate effect of what is being contended for in the instant case.

Considering several factors,[31] the court found a value of $4,000, although it had noted that the ceiling prices set by the Office of Price Administration would yield $8,100.84 on the domestic market and $9,180.95 on the export market and that "[t]his would undoubtedly be the rate of compensation had there been a market for these tires," *id.* at 359. The award, apparently, was the value of the tires to the condemnee for its own use, *see id.* at 361, 362. *See also Wilson Athletic Goods Mfg. Co.* v. *United States,* 161 F.2d 915 (7 Cir. 1947), rejecting the government's scrap valuation for certain processed aluminum sporting goods and considering instead "all factors existing at the time of the seizure," *id.* 917, where an order of the War Production Board had "destroyed the ordinary market for aluminum," *id.*, and stating that the property taken "could have been held by plaintiff and later used for the purposes for which it had been fabricated," *id.* at 918; *Illinois Pure Aluminum Co.* v. *United States.* 67 F. Supp. 955 (Ct. Cl. 1946), *cert. denied,* 330 U.S. 834 (1947), where the court also considered "all the facts and evidence," *id.* at 958, in fixing just compensation for aluminum requisitioned after orders of the War

31. Specifically, 112 F. Supp. at 362:

> the fact that the value of the tires as manufactured articles was far above the price of scrap, the fact that they were purchased for a specific use and not for a speculative purpose, . . . the wartime conditions that existed, the necessity for special allocations and priorities, the natural and proper restrictions that are placed around the disposition of materials in a period when the world is torn by war, and . . . the various regulations and restrictions and limitations that were placed upon articles of this character and made of this material. . . .

Production Board that were said to have "limited the use of aluminum, finally throwing a curtain of steel around its disposition so that its use was practically limited to war purposes," although noting that "we do not think plaintiff can justly claim a value that would have prevailed had no wartime regulations or controls existed or been necessary," *id.* at 956; and *Seven-Up Bottling Co. of Los Angeles, Inc.* v. *United States,* 68 F. Supp. 735 (Ct. Cl. 1946), *cert. denied,* 332 U.S. 757 (1947), where the restrictions the Government placed on the use of waters after Pearl Harbor destroyed the market for yachts, and the court in compensating the owner of the requisitioned vessel took into consideration "the conditions that prevailed and the intrinsic value of the vessel," *id.* at 736, including depreciation and the cost of maintenance while the vessel was in lay-up status.

In two other cases, the Government's pre-taking activity affecting market value related peculiarly to the property taken. In the first case, *Turney* v. *United States,* 115 F. Supp. 457 (Ct. Cl. 1953), the court was presented with the task of valuing certain classified radar equipment that had mistakenly fallen into private hands in the Philippines as part of a sale of government surplus. After negotiations for return of the equipment stalled, the Federal Government arranged for an embargo of the property by the Philippine government in contemplation of its repossession. Emphasizing the Federal Government's role in preventing any sale—the owners had commenced negotiations with the Chinese Nationalist Air Force—the court set an award of $75,000, although the Government's procurement cost was $441,889.79 and the Government in selling similar property as surplus sought $36,825 or $7,365.50 (depending on the appropriate classification). *See* 115 F. Supp. at 464-65.

In the second case, *United States* v. *220.0 Acres of Land (Assateague Island Condemnation Case),* 324 F. Supp. 1170 (D. Md. 1971), the United States condemned Assateague Island for preservation as a National Seashore. The Government sought valuation based on sales of lots in certain parts of the island in

past years while the owners claimed "that prices during those years were depressed by special and unusual circumstances, including actions taken by the State of Maryland at the instance of the Secretary of the Interior." *Id.* at 1172 (footnote omitted). After setting out in detail the activities of the federal and state governments in discouraging the private development of the island, the court ruled that such depressed market values could not be dispositive of just compensation. *See id.* at 1180:

> The principal legal problem in this case is the effect that should be given to the actions of the State of Maryland, which were induced to a considerable extent by the Secretary of the Interior, and were intended to prevent any building on Assateague during the years 1963-1965. . . .
>
> The Court concludes that in the context of the present case the consequences of those actions should not be ignored or dismissed as "incidents of ownership." It would be unfair to permit the condemning agency to depress property values, directly or indirectly, by interfering with the property owners' rights to use their land, and then take advantage of such depression to reduce the price which it must pay for the property.

In sum, the cases hold that the Government may not manipulate a market to depress prices and then benefit from the reduction.

In an effort to bring themselves within these cases, the transferors have mounted an extensive presentation to show that public policies toward the railroads have had such a depressing effect as to entitle them to a valuation on the basis of a market somehow reconstructed so as to be free from these adverse effects or on some other basis that would more properly reflect the "intrinsic" value of their properties. A particularly impressive showing with respect to such public policies was made in the opening brief of

Intervening Penn Central Lienholders. Citing a long list of governmental publications,[32] this analysis divided the detrimental public policies into two general categories:

First,

> Public (federal, state and local) financial subsidies to the intermodal competition of the railroads which decisively favored rival modes and hurt the railroads at precisely the time that such a competitive disadvantage was most likely to jeopardize the survival of the railroad. . . .

And second,

> A regime of regulatory and political constraints governing the railroads that stifled efforts to respond to larger economic forces impacting the railroads and to the specific challenges of less regulated intermodal competition; all evidenced by artificial and destructive policies on such subjects as rates, divisions, technological and service innovations, labor relations, service and branch line curtailment, to name just a few.

(Brief at 96-97).

In support of the former, the brief quotes from the Preliminary System Plan

32. Staff of the Senate Comm. on Commerce, 92d Cong., 2d Sess., The American Railroads: Posture, Problems and Prospects (Comm. Print 1972); Staff of Senate Comm. on Commerce, 92d Cong., 2d Sess., The Penn Central and Other Railroads (Comm. Print 1972); U.S. Dept. of Transportation, Northeastern Railroad Problem (1973); USRA, Final System Plan (1975); USRA, Preliminary System Plan (1975); U.S. Department of Transportation, Rail Service in the Midwest and Northeast Region (1974); Rail Services Planning Office of I.C.C., Evaluation of the U.S. Railway Association's Preliminary System Plan (1975); I.C.C., Means for Preserving and Maintaining Essential Rail Services, Report Pursuant to S.J. Res. 59 (1973); Task Force on Railroad Productivity of The National Commission on Productivity and The Council of Economic Advisers, Improving Railroad Productivity (1973).

Appendix E

> The early assistance to railroads pales when compared to the continuing aid given to the development of the private automobile and trucking industry, the airlines and inland barge operations—all competitors to the railroads.
>
> Through 1973, total federal, state, and local expenditures to support rival forms of transportation have been in excess of $450 billion, most of it spent since 1920.

PSP, Vol. I, at 4.

Federal, state and local government expenditures for highways between 1951 and 1973 amounted to almost $305 billion and for waterways to almost $14 billion. At the same time the railroads were able to invest only about $37.5 billion, all internally generated or privately raised. Moreover, whereas the highways and waterways are free from state and local taxes, these consumed more than half of the pre-federal income tax net railway operating income of the Class I railroads for many years until by 1970 they exceeded such income. The railroads were burdened with the capital costs of providing and maintaining their rights of way whereas their motor and water competitors were not. The railroads were also burdened by regulation, particularly by use of the minimum rate power to prevent their competing more effectively with motor and water carriers. The PSP, Vol. I at 4, cited a recent study which estimated the enormous loss from excess capacity and misallocation of resources attributable to regulatory inadequacies as ranging from $4 to $9 billion annually. *See also* Friedlaender, *The Social Costs of Regulating the Railroads, 61 Papers and Proceedings of the American Economic Assoc.* 226, 234 (1971) (estimating $2.4-3.8 billion loss in 1969). The brief lists various defects and inadequacies in rate regulation, prohibition of diversification into other modes of transportation, failure to increase the divisions of the railroads in the northeastern region, refusals to allow the railroads to terminate light density lines and losing passenger service, and what is claimed to be unduly favorable treatment of job protection for railroad labor, as

instanced, for example, by Senate Joint Resolution 59 of February 9, 1973, Pub. L. 93-5, 87 Stat. 5, noted in our CUE opinion, p. 14, which thwarted the efforts of the PC Trustees to reduce the size of train crew consists.[33]

While answers can doubtless be made to some of this barrage of charges, we have little doubt that the governmental policies and actions we have here summarized and others we have omitted in the interest of brevity have contributed greatly to the plight of the northeastern railroads. Not denying this, the Government parties assert that such matters may not be taken into account in fixing "just compensation" unless the governments' acts were unconstitutional, which the transferors other than Reading, *see* fn. 35 *infra*, have not claimed.

The decisions discussed up to this point do not support the broad conclusion the transferors would have us draw from them. *Buxton Lines, Swiss Federal Railways, Wilson Athletic Goods, Illinois Pure Aluminum,* and *Seven-Up Bottling* were concerned with distortion of market conditions related to wartime governmental needs or exigencies, not to governmental activity serving more traditional regulatory or promotional purposes. The courts have deemed it somewhat unfair to ignore market values that will be shortly attainable—and indeed would have been attainable during the war if the Government had not prevented their realization.[34] Furthermore, when an industry has not been directly

33. For a thorough review of Federal regulatory and tax policies regarding the railroads and other forms of transportation, see Study of Federal Aid to Rail Transportation: Report of the Secretary of Transportation to the United States Congress Pursuant to Section 902 of the Railroad Revitalization and Regulatory Reform Act of 1976 (1977), especially chapters III, IV and V.

34. These cases may thus be thought to be akin to those that would disregard fluctuations owing to periods of depression or boom markets—a situation where the decisions are said to go both ways. *See* 4 *Nichols, supra* § 12.3112; 1 *Orgel* §§ 24-25. *See also United States* v. *Cors,* 337 U.S. 325, 333-34 (1949), indicating that an increase even in private market price attributable to the Government's wartime needs is not compensable. It should also be noted that the Supreme Court in *United States* v. *Commodities Trading Corp.,* 339 U.S. 121, 125-29 (1950), disapproved compensation for so-called "retention value"—the

regulated but is affected incidentally by temporary regulation designed towards another end, the investors may well not have taken the prospect of government action into account. In contrast when an industry has long been the subject of direct and permanent regulation, governmental action is taken into account by those investing in it. Regulation has been a fact of life in the railroad industry for a century, and government assistance in the building of roads, canals—and later the railroads themselves—goes back to the early days of the Republic. If a state chose to condemn a toll road, the owners of the latter could not successfully claim that it must be valued on a basis that would ignore the competition from free roads the state had built. *Turney* and *Assateague Island* are even further removed from this case as in both the inadequacy of the market was caused by the taker's actions which had the direct effect of reducing the market value of the specific property that was shortly to be taken.

A decision closer to supporting the transferors' position is that of a badly split New York Court of Appeals in *In re Fifth Ave. Coach Lines, Inc.*, 18 N.Y.2d 212, 273 N.Y.S.2d 52 (1966), *appeal dismissed*, 386 U.S. 788 (1967). The majority of four there held that a condemnation award of "going concern" value to a formerly profitable bus line which had lost its earning capacity was required when the loss of earning capacity was not due to "the economic law of diminishing returns or inefficient management"

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value of the right to hold on to property until a value-reducing governmental regulatory scheme (in that case, Office of Price Administration ceiling prices on pepper) came to an end and then to dispose of it—a result that would call into question the result in the cases here under discussion to the extent that they reflect the notion that the property should be valued at greater than a depressed market value because of such a "retention value." *See Swiss Federal Rys., supra*, 112 F. Supp. at 360 (attempting to distinguish *Commodities Trading Corp.*) 4 *Nichols, supra* § 12.3111, at 12-131 n.6 (suggesting that *Swiss Federal Rys.* "implicitly recognized" the "retention value" rejected by *Commodities Trading Corp.*). *See also United States* v. *Felin & Co.*, 334 U.S. 624 (1948) (upholding award based on OPA ceiling prices for commodities).

but occurred because New York City, which was both the condemnor and the ratemaking authority, had denied "for political reasons, the right to charge an increased and reasonable fare" that would have yielded "large gains in gross revenues and greater gains in net profits as going concerns at the time of condemnation." *Id.* at 220-21, 273 N.Y.S.2d at 56.

We basically disagree with the *Fifth Avenue Coach* majority. Railroads, like other forms of business, take their chances on what government may do in the way of regulating them or helping their competitors. So long as government has not acted beyond its constitutional powers, a condemnee is not entitled to the recognition of values that have been impaired by a long and established course of government action.[35] Two judges joined Judge Keating in a dissent saying that:

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35. We expressly reject the claim of the Trustee of the Reading that "regulatory strangulation" and particularly approval of the Penn Central merger constituted a taking. In regard to the merger, as pointed out in our CUE opinion, p. 52, and in *Erie-Lackawanna R.R.* v. *United States,* 279 F. Supp. 316, 330-32 (S.D.N.Y. 1967), *modified and aff'd Penn Central Merger and N & W Inclusion Cases,* 389 U.S. 486, 519-20 (1968), Reading had ample opportunities to protect itself both in the B & O—C & O and in the Penn Central merger proceedings but neglected to avail itself of them until too late. *See also* Brief of Reading Co. at 56-57. The Reading also offered no timely challenges to the other regulations it now assails as unconstitutional. The argument that *United States* v. *Dickinson,* 331 U.S. 745, 749 (1947), entitled the Reading to delay bringing suit for 70 years after it claims the "regulatory strangulation" began, and nine years after consummation of the Penn Central merger stretches that case beyond reason. In *Dickinson,* the Court held that since the rising of the water level after construction of a dam was continuous, the statute of limitations did not begin to run until a final account of the damages could be struck. In *Klein* v. *United States,* 152 Ct. Cl. 221, *cert. denied,* 366 U.S. 936 (1961), where there were regular airplane flights over plaintiffs' property and in *Gregory* v. *City of New York,* 346 F. Supp. 140 (1972), where the plaintiff alleged a continuing trespass because of the city's diversion of a river in which he had riparian rights, the courts followed *Dickinson.* Here, by contrast, the regulatory actions described by Reading were a series of discrete events offering numerous opportunities for objection.

Even if Reading's claim of a regulatory taking were valid, it would not alter the standard to be applied in the determination of CMV, but would give rise to a claim for compensation independent of the one pressed in

> Political considerations, in this case the pocketbook of the millions of New Yorkers who use the transit system daily, are not to be shrugged off lightly. This was a fact of life with which the claimants were required to contend throughout their operating existence. The announcement of condemnation did not herald an end to their burden—at least it should not with regard to valuation. . . .

Moreover, even if we agreed with the majority in *Fifth Avenue Coach*, it would not bridge the gap between the cases discussed at the beginning of this section and the result that the transferors wish us to reach. Whereas in *Fifth Avenue Coach* a court could quantify the result of rate increases that had been sought and denied, no one could possibly determine what the bankrupt railroads would have earned if government had not taken, or had taken less of, the various promotional and regulatory steps of which the transferors complain.

(4) *The patent cases*

The line of decisions most helpful to the transferors' contention that value to the taker must be considered in some circumstances are cases, arising under 28 U.S.C. § 1498(a), where the Government has infringed a patent having no or little commercial use and the Court of Claims has considered the value to the Government—in some instances hypothesizing a bargaining process such as we have described above. The principal cases relied on by the transferors are *Olsson* v. *United States*, 25 F. Supp. 495 (Ct. Cl. 1938), *cert. denied*, 307 U.S. 621 (1939); *Marconi Wireless Telegraph Co.* v. *United States*, 99 Ct. Cl. 1 (1942), *rev'd in part on other grounds*, 320 U.S. 1 (1943); *Badowski* v. *United States*, 278 F.2d 934 (Ct. Cl. 1960); *Saulnier* v. *United States*, 314 F.2d 950 (Ct. Cl. 1963); *Ushakoff* v. *United States*, 375 F.2d 822 (Ct. Cl. 1967); *Amerace Esna Corp.* v. *United States*, 462 F.2d 1377

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this Court, a claim for which we would not have the power to order relief.

(Ct. Cl. 1972); and *Tektronix, Inc.* v. *United States*, 522 F.2d 343 (Ct. Cl. 1977).

The most recent case, *Tektronix*, applied a willing buyer-willing seller approach to an instance where the patent had commercial value, but where the court deemed there was no established royalty rate. *Olsson*, the case most helpful to the transferors, applied a similar approach to a patent on howitzer recoil mechanisms which had no commercial value, and used cost-savings to the Government as a basis for determining a reasonable royalty. In *Ushakoff*, where the patent on solar-powered water stills again had no commercial value, the court set a rate of slightly under 5 percent, apparently based on customary commercial standards. In *Badowski*, there was a limited commercial market for the patented parachute release device; the willing buyer-willing seller approach was used by taking the prior commercial license rate as a benchmark, and then reducing the royalty somewhat because of the greater volume purchased by the Government. In *Saulnier*, the patented airplane canopy had no established commercial royalty rate and the court used the patent owner's settlement of an earlier claim against the British Government as a guide. In *Marconi Wireless*, there was no assertion that the patented radio circuitry had value only in Governmental uses; the case applies a percentage-of-cost-savings approach to establish reasonable compensation—apparently because the finished radios sold by an infringer to the Government embodied several different patents and it was thus difficult to determine a gross sales figure to which a royalty should be applied. In *Amerace Esna*, there were no industrial licensing agreements to serve as a standard for the patented process of removing rust from ballast tanks, but it does not seem very plausible that the invention was without any commercial application. The court rejected a cost-savings approach as lacking factual support and instead resorted again to the fiction of a willing buyer and willing seller agreeing on the apparently common 5 percent royalty.

Apart from the facts that the Court of Claims' application of the willing buyer-willing seller approach to the Government in these cases has never been passed upon by the Supreme Court and that the benefits realized by the patentees from that approach have been rather modest, we do not believe the cases support the broad conclusions the transferors would have us draw from them. They are distinguishable on several grounds. One lies in the origins of 28 U.S.C § 1498(a), under which these cases were decided.

28 U.S.C. § 1498(a) provides in pertinent part:

> Whenever an invention described in and covered by a patent of the United States is used or manufactured by or for the United States without license of the owner thereof or lawful right to use or manufacture the same, the owner's remedy shall be by action against the United States in the Court of Claims for the recovery of his reasonable and entire compensation for such use and manufacture.
>
> For the purposes of this section, the use or manufacture of an invention described in and covered by a patent of the United States by a contractor, a subcontractor, or any person, firm, or corporation for the Government and with the authorization or consent of the Government, shall be construed as use or manufacture for the United States.

The statute is derived from the Act of June 25, 1910, c. 423, 36 Stat. 851, as amended by the Act of July 1, 1918, c. 114, 40 Stat. 705. The 1910 statute provided in pertinent part:

> That whenever an invention described in and covered by a patent of the United States shall hereafter be used by the United States without license of the owner thereof or lawful right to use the same, such owner may recover reasonable compensation for such use by suit in the Court of Claims . . . .

The 1918 amendment changed the standard of compensation from "reasonable compensation" to "reasonable and entire compensation," and made recovery available not only when the United States had "used" an invention covered by a patent, but whenever the invention had been "used *or manufactured* by *or for* the United States."[36]

Before 1910, the protections afforded a patentee against the Government's use of his patent were strangely limited, even though it was clear that governmental use was one of the exclusive proprietary rights belonging to the patentee, *see Schillinger* v. *United States*, 24 Ct. Cl. 278, 296 (1889), *aff'd*, 155 U.S. 163 (1894); *William Cramp & Sons Ship Building Co.* v. *International Curtis Marine Turbine Co.*, 246 U.S. 28, 39-40 (1918). If a governmental officer acting within the scope of his authority and acknowledging the validity of the patent made use of the patent *with the owner's permission*, either express or implied, the United States was considered liable to a contract action in the Court of Claims for reasonable compensation.[37] *See e.g., William Cramp & Sons Ship Building, supra*, 246 U.S. at 40. *See also United States* v. *Société Anonyme Des Anciens Etablissements Cail*, 224 U.S. 309 (1912); *McKeever* v. *United States*, 14 Ct. Cl. 396, 422-24 (1878), *aff'd* 18 Ct. Cl. 757 (Sup. Ct. 1882); *Schillinger* v. *United States, supra*, 24 Ct. Cl. at 298. Such an action could be brought even though the amount of compensation had not been agreed upon, so long as the parties' mutual consent to the use of the patent could be implied, *see United States* v. *Berdan Fire-Arms Manufacturing Co.*, 156 U.S. 552, 569

36. In 1960, a section covering copyrights and paralleling old § 1498's provisions for patents was added as § 1498(b), *see* Act of September 8, 1960, Pub. L. 86-726, §§ 1, 4, 74 Stat. 855, 856.

37. The first act providing jurisdiction in the Court of Claims for claims founded upon "any contract, express or implied, with the government of the United States" was the Act of February 24, 1855, c. 122, 10 Stat. 612; that provision was later incorporated into the Tucker Act, Act of March 3, 1887, c. 359, 24 Stat. 505, now codified as 28 U.S.C. § 1491. *See Hart & Wechsler, The Federal Courts and the Federal System* 1326-27 (2d ed. 1973).

(1895). However, where the Government officer did not have prior knowledge of or disputed the patent right or where the owner had not manifested consent, the existence of a contract could not be implied and the only redress of the patentee was an action in tort against the individual official. *See William Cramp & Sons Ship Building, supra,* 246 U.S. at 40-41. *See also Crozier* v. *Fried, Krupp Aktiengesellschaft,* 224 U.S. 290, 302-04 (1912); *Interdent Corp.* v. *United States,* 488 F.2d 1011, 1013 (Ct. Cl. 1973).

The objective of the 1910 statute thus was to place the patentee who had not consented, either because the Government had not sought his consent or because it had been impossible to reach an agreement, on the same footing as the patentee who could spell out some form of consent and sue on an implied contract. In working out what the terms of such an implied contract would have been in situations where no other standards were available, the Court of Claims would necessarily have had to consider what agreement the patentee and the Government would have reached. It is thus not surprising that, despite the many references by the Courts of Claims and some by the Supreme Court to § 1498 and its predecessor as being an eminent domain statute,[38] the purpose of the 1910 statute to equate the non-consensual with the consensual transaction has properly, if perhaps not always consciously, entered into the manner in which just compensation is determined.

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38. *See, e.g., Crozier* v. *Fried, Krupp, supra,* 224 U.S. at 304-05; *William Cramp & Sons Shipbuilding Co.* v. *International Curtis Marine Turbine, supra,* 246 U.S. at 42; *Irving Air Chute Co.* v. *United States,* 93 F. Supp. 633, 635 (Ct. Cl. 1950); *Interdent Corp.* v. *United States, supra,* 488 F.2d at 1013; *Tektronix, Inc.* v. *United States, supra,* 552 F.2d at 346-47.

Although the Court of Claims has stated that § 1498 is "unrelated to contract doctrine," *Interdent Corp.* v. *United States, supra,* 488 F.2d at 1013, the court was merely holding that amendment of § 1491 to extend the court's jurisdiction to contracts and implied contracts of military exchanges did not authorize the court similarly to extend § 1498. The holding that § 1498 is not meant to govern contractual relationships is entirely consistent with the views we have expressed above.

A further basis of distinction—perhaps only a different way of stating the same one—is this. In the cases relied upon by the transferors, the Government was not taking the patent but rather a non-exclusive license for governmental use. As noted in a somewhat different context, *Schillinger* v. *United States, supra,* 24 Ct. Cl. at 298-99,

> There may be a distinction between the taking of intangible property, such as a patent right, and the taking of tangible property in this, that by the Government's use of a patent right the owner loses nothing *per se* through the taking; whereas if a tangible article be appropriated the owner instantly becomes so much the poorer . . . . [T]he use of a patented process or article may directly deprive the owner of nothing of intrinsic value, but be simply an invasion of a right . . . .

The value of which the patentee is deprived by the Government's taking a nonexclusive license is the value he might have obtained by *selling* a license or the finished patented product to the Government itself. This is true of *every* case where the Government infringes a patent, even where the patent has significant commercial value, so long as the governmental use of the patented invention does not diminish the market demand for the patent for nongovernmental uses. It should therefore be no surprise that in the instances where there happens to be no or little nongovernmental use, the Court of Claims should have sought to construct a market. Yet even in such cases the Court of Claims does not generally apply a value to the taker concept in the sense of giving significant weight to the Government's necessities. The Court of Claims has not used governmental cost-savings as even a basis of calculation under § 1498 since the *Marconi* case in 1943, *see Amerace Esna, supra,* 462 F.2d at 1379-80 & n.4, and *Tektronix* v. *United States, supra,* 552 F.2d at 347-48 & n.5, and has rejected cost-savings calculations when they resulted in royalties

which were unusually high by commercial standards, *see Ushakoff* v. *United States, supra,* 375 F.2d at 825.

Finally, while we find little merit in the broad contention of the Government parties that the results of the cited cases were dictated by the very existence of a patent system which is designed to encourage inventors by offering them suitable rewards, a narrower form of the argument has validity. This is that since adoption of the predecessor of 28 U.S.C. § 1498(a) in 1910, the Government has held out the promise to inventors that if it used their inventions without their consent, it would pay suitable compensation. Many inventors may have proceeded in reliance on this representation. To read the statute as denying compensation in cases where the invention was of no or little use save for governmental purposes would indeed keep the word of promise to the ear but break it to the hope. Congress held out no similar invitation in the Rail Act—a statute designed to preserve a failing transportation system from completely disappearing, at the minimum cost to the taxpayers permitted by the just compensation clause, and there is no suggestion that any transferor has constructed its railroad in the expectation that the Government would take it over.[39]

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39. *Armstrong* v. *United States,* 287 F.2d 577 (Ct. Cl. 1961), is somewhat similar to the patent cases. There, the Government had terminated a contract for construction of 11 boats and acquired possession of them and construction materials before 10 of the boats were complete. The plaintiffs had a materialmen's lien on this property, and the Supreme Court held that there had been a taking of their property interests for which compensation was required. *Armstrong* v. *United States,* 364 U.S. 40 (1960). On remand in the Court of Claims, the Government claimed that its prior lien for progress payments exceeded the value of the ships, so that the plaintiffs' lien was valueless.

The Court found that the ships had little or no market value because of their specialized construction and because "there was not a great market for unfinished boats any more than there would be a general market for a suit of clothes with just one leg of the trousers finished, even though the remaining material were furnished with the partially finished suit of clothes." *Id.* at 580. In determining the value of the plaintiffs' materialmen's lien, the Court therefore sought to determine the "actual and intrinsic value of the ships," considering the amount the Navy had

(5) *Condemnation of unprofitable public utilities for continued use*

The transferors cite a number of cases where the condemnor of unprofitable public utilities for continued use as such was required to pay more than liquidation value which in those instances seems to have been a sale as scrap. If we leave for further discussion the decision of the New York Court of Appeals in *In re Port Authority Trans-Hudson Corp. (PATH)*, 20 N.Y.2d 457, 285 N.Y.S.2d 24 (1967), *cert. denied*, 390 U.S. 1002 (1968), five of the cases awarded original cost (OC), original cost less depreciation (OCLD) or an amount between OCLD and scrap value; four awarded reproduction cost new less depreciation (RCNLD). The cases which give some or controlling weight to OC or OCLD are *In re Fair Oaks Irrigation District*, [1918C] P.U.R. 879 (Cal. Railroad Comm'n 1918); *In re City of Eureka*, 19 Cal. R.C.D. 952 (1921); *In re City of Oroville*, [1922 E] P.U.R. 451 (Cal. Railroad Comm'n 1922); *In re Aldercroft Heights County Water District*, 60 P.U.R.3d 227 (Cal. Public Utils. Comm'n 1965); and *In re City of Washburn*, [1924 D] P.U.R. 368 (Wis. Railroad Comm'n 1924). The cases giving controlling weight to RCNLD are *Appleton Waterworks Co.* v. *Railroad Comm'n of Wisconsin*, 154 Wis. 121, 142 N.W. 476 (Sup. Ct. 1913); *Lanneau* v. *Capital Transportation Corp.*, 292 So.2d 810 (La. Court of Appeals 1974); *In re Ottawa and Gloucester Road Co. and County of Carleton*, 69 D.L.R. 486 (Ontario Sup. Ct. App. Div. 1921); and *International Railway Co.* v. *Niagara Parks Comm'n* [1937] 3 D.L.R. 305 (Privy Council).

We can pretermit discussion of the cases giving weight to OC or OCLD since this subject will arise in our discussion of *PATH*.

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contracted to pay for them, and the amount the shipbuilder had expended.

The case is not analogous to this one. The ships were built at the request of the Government and were only useful for the Government's purposes.

The RCNLD cases are distinguishable on their facts. In the *Appleton Waterworks* case, one of only two rendered by courts in the United States, it is not clear that the utility was incapable of profitable operation; the condemnation by the city seems to have been caused by the utility's inability to improve the service rather than by the impossibility of going on.[40] In *Lanneau*, the other case decided by a United States court, the city's own appraiser had used a RCNLD approach and the court endorsed his valuation, rejecting the plea of the losing utility for the addition of "going concern" value.[41] The *Ottawa and Gloucester Road Company* decision may have been affected by the existence of other "public bodies which might have taken over the roads, if the county had not done so," 69 D.L.R. at 489-90 (opinion of the trial court). In the *International Railways* case the Privy Council was construing an agreement that at the end of the franchise the railway should be "duly compensated for their railways, equipment, machinery and other works. . . ." 3 D.L.R. at 308. The Judicial Committee was influenced by the point that "[T]he meaning of the agreement must be the same whether the railway proved a success or a failure" and that since in the former event the Park Commission would not have been required to compensate for loss of future profits, it would be unfair to allow the

40. Upon application of the city, the railroad commission in May 1910 ordered the utility to make improvements in its plant before rate increases would be granted. Three months later, the city called an election to determine whether it should purchase the plant.

Although the utility was in receivership and a mortgage on its property had been foreclosed, there was evidence that expenditure of "at least $50,000" would render the plant "reasonably efficient," 154 Wis. at 149, 142 N.W. at 485, and no indication that there was any difficulty in meeting operating expenses. Indeed, the court's statement that in valuing the enterprise, it could not add together the value of specific items but had to determine "as accurately as possible the revenue producing power of the entirety on the basis of reasonable charges for service to customers," 154 Wis. at 144, 142 N.W. at 483, indicates that the court itself did not consider the utility to be truly unprofitable.

41. The court also noted than although the parties "to some extent" treated the litigation as an "expropriation proceeding," it was in fact merely a suit on a contract. 292 So.2d at 816.

Commission to pay only "break-up value" when the operation had become a losing one. *Id.* at 315. Moreover, the RCNLD decisions are rather dated and came from a period when reproduction cost enjoyed a greater favor than it now does (see the discussion below), and none explicitly considered the just compensation clause of the Fifth Amendment.

Despite this, the Government parties have not met the challenge of the transferors to produce a single decision in which a losing public utility being taken for continued use was valued as scrap[42] and the opinions convey a sense that such a solution would

42. The *New Haven Inclusion Cases, supra,* 399 U.S. 392, do not qualify for this role, as the Government parties urge. The New Haven was not a condemnation case, and the Court held only that an agreement between the New Haven reorganization trustees and Penn Central to sell the New Haven's assets on the basis of their liquidation value was, under the circumstances, "fair and equitable" within § 5(2) of the Interstate Commerce Act. The Court rejected the New Haven bondholders' claim to superimpose "going concern" value on liquidation value. *Id.* at 481-82. No one had argued, however, that the entire valuation should have been on a different basis, such as OCLD or RCNLD.

Market Street Railway Co. v. *Railroad Comm'n of California,* 324 U.S. 548, 564-68 (1945), comes closer to meeting the transferors' challenge. The Court there held it was not a denial of due process for a state to fix rates for a hopelessly losing street railway that would produce a fair return on the price of $7,950,000 at which the properties had been offered to the City of San Francisco, as against much higher figures of reproduction cost, book value and outstanding securities issued with the approval of the regulatory commission. Mr. Justice Jackson said, 324 U.S. at 567:

> The owners of a property dedicated to the public service cannot be said to suffer injury if a rate is fixed for an experimental period, which probably will produce a fair return on the present fair value of their property. If it has lost all value except salvage, they suffer no loss if they earn a return on salvage value. If the property has no prospect of salvage except through dismantling and sale for scrap, the scrap value for such of it as is to be scrapped may represent its present worth.

The record in the *Market Street* case does not disclose what the scrap value would have been. The transferors also urge that the quoted remarks were dicta as the Court had found that the rates that were upheld produced "all that the company could earn," 324 U.S. at 566, since any higher rates would have driven traffic away.

be unacceptable, at least if scrap value were negligible.[43] That is the rationale—the Government parties say lack of rationale—of Judge Keating's opinion for the New York Court of Appeals in *PATH*.

Of all the cases brought to our attention, *PATH* provides the strongest support for deviating from the market value rule. That case was concerned, among other matters, with the condemnation of four single track railway tunnels under the Hudson River and subterranean tunnels connecting them with passenger terminals in New York and New Jersey. The operation was a hopelessly losing one. The trail court awarded $30,000,000, "predicated on the conclusion that the condemnees should at least be repaid for the depreciated original cost of the tunnels," 20 N.Y.2d at 471, 285 N.Y.S.2d at 32, as against a figure of $400,000,000 for reproduction cost and a zero liquidation value as scrap. The Appellate Division reduced the award to "virtually nothing." The Court of Appeals restored the award of the trial court, saying:

> Can it be said by any objective standard that an award of scrap value—*nothing*—is fair and just for the tunnel property, an essential part of an essential public facility, which cost some $32,000,000 to construct, which would cost in excess of $400,000,000 to reproduce and which, with some minor expenditures will function as good as new for an indefinite period? We think not. . . .

43. The attitude embodied in these cases is encapsulated by Justice Latchford's remark in the *Ottawa and Gloucester Road Co.* case; noting the possibility that the owners should have been paid nothing because the properties had neither positive earning capacity nor scrap value, he said, "I am glad that no such view was taken . . . ." 69 D.L.R. at 494.

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20 N.Y.2d at 470, 285 N.Y.S.2d at 32.[44] While *PATH* is not binding upon us,[45] this decision demands serious attention.

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44. The Court also said:

> We are here concerned with a property which has a usefulness created by the owner himself through the expenditure of large sums of money and by the continued operation of the property for the very purpose for which the petitioner is acquiring the property. It is the owner who built the "reservoir"—the Tube railway system in the present case. This owner has developed its property at a cost of millions of dollars and operated it for more than 50 years. It is admittedly of great usefulness in the daily transportation of thousands of commuters. A condemnor should not be permitted to tell him: "It's only worth scrap or less".

20 N.Y.2d at 468, 285 N.Y.S.2d at 30.

The *PATH* case also involved non-tunnel properties. As to these, while the Court of Appeals disapproved the Appellate Division's award of scrap value "solely on the basis of unprofitability of the enterprise," 20 N.Y.2d at 471, 285 N.Y.S.2d at 32, it also disapproved the trial court's award of $20 million "on the basis of original cost less an amount for depreciation which had no support in the record" on the ground "that much of the non-tunnel property was severely deteriorated, and that an expenditure of almost $32,000,000 would be necessary to rehabilitate the non-tunnel property whereas only $88,000 was all that would be required to restore the tunnels." 20 N.Y.2d at 471, 285 N.Y.S.2d at 33. The court added that the record indicates that, despite rising costs of labor and equipment, the original cost of the non-tunnel property exceeded the depreciated reproduction cost of that property and the award made by Special Term was only some $3,000,000 less than the depreciated reproduction cost. By comparison, the award for the tunnel property, which gave effect to the unprofitability factor, was less than one fifteenth the depreciated reproduction cost. It is thus clear that Special Term not only failed to give effect to the physical and technological obsolescence of the property but that it also apparently ignored the enormous expenditure which was required to rehabilitate the property and did not give any significant effect to the unprofitability factor.

Id.

45. We do not agree with the contention of some transferors that *PATH* was "approved" by the Supreme Court in *The New Haven Inclusion Cases, supra,* 399 U.S. at 482-83, n.80. The Court summarized the holdings of the *Fifth Avenue Coach* and *PATH* cases and said that in neither did the New York Court of Appeals "require the taking authorities to pay *both* an operating and a liquidating value" but rather had "awarded the owners the value reflecting the highest and best use for their properties . . . ." It would go too far to read into the latter remark a

Both the majority and the minority in *PATH* sought to draw comfort from Mr. Justice Cardozo's opinion in *Roberts* v. *New York City*, 295 U.S. 264 (1935). That decision is not easy to understand. The case concerned the valuation of a losing spur of an elevated railroad; the New York Court of Appeals had allowed the scrap value of the spur and the original cost to the railroad in acquiring easements of light, air and access. The railroad's receiver and others allied in interest with him obtained certiorari; the City acquiesced in the decision of the New York Court of Appeals. The subject principally discussed in the Supreme Court's opinion was the adequacy of the award for the easements which if they had to be acquired at the date of condemnation would have cost $3,600,000 as against the original cost of $539,117.41 that had been awarded. The Court held, 295 U.S. at 282, that "the award is not too low, though perhaps it is too high." It pointed out that the easements were useful only in connection with operation of the spur and said, in the words stressed by the dissenting judge in *PATH* and by the Government parties here, that

> Substantial prices are not paid for the privilege of conducting a business at a loss.

Id. The Court also sustained the award of only $235 for the scrap value of the spur, *id.* at 284, saying:

> The structure was appraised as junk, the city having undertaken to bear the cost of removal. *Such an appraisal might be too low were it not for the award for the private easements.* To realize the value of those easements, an abandonment of the spur was necessary. "The railroads could not release their rights to the abutting owners and continue to operate their railroads in the

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requirement that the principle adopted in *PATH* must be applied in federal condemnation.

> street." 265 N.Y. at p. 181. The structure in the circumstances had no value except as scrap. (Emphasis supplied.)

The *PATH* majority, and here the transferors, stress the italicized sentence, which could mean that when the condemnation is of a railway not possessing easements of light, air and access, scrap value would not be enough even when there is no continued use. Against this are the final sentence and the previous discussion. We thus derive little help from *Roberts*.

B. *Applicability of the Market Value Rule to this Proceeding*

While the cases previously reviewed do not carry the weight the transferors would give them, we cannot be wholly insensitive to the views that seem to underlie them. The courts rejected market value as the measure of just compensation in circumstances which made that measure suspect.

Circumstances peculiar to this case make market value particularly hard to prove. The transferors face serious difficulties in proving alternative scenario sales and the amounts that would have been obtained from those sales. These difficulties are increased by the chilling effect, not disputed by the Government, that serious discussion of the Rail Act had on the prospect of such sales. The discussion and enactment of the Act eliminated any incentive other parties might have had to negotiate purchases.

This does not mean that we should reject the role of market value in determining just compensation. Nor, however, should we bind a notion as fundamental as just compensation by the sterile logic of provable market value if a manifestly unfair result is produced. We may have such a situation here. It seems incredible that these 19,000 miles of railway and freight and passenger terminals, together with the equity in rolling stock, were worth only $685 million, the sum arrived at in the revised

MLP of March 1, 1976.[46] It is nearly as unbelievable as the zero award in *PATH*. Of course, the revision of MLP now in progress or attacks on it by the transferors may considerably augment this figure.[47] It may also be that the transferors will succeed in showing a higher value by proving the potential salability of some of the property for rail use. The Government parties might be well advised not to be overly finical in their attitude toward such proof.

It suffices now to note that if the transferors should not be able to establish a figure for NLV which would square with our notions of what constitutes "just compensation," we may be obliged to consider some other method to arrive at CMV. This would not be to deny the thesis of the Government that value to the taker should not be considered. However, if the unique circumstances of this case make it impossible to establish a market value which constitutes just compensation, it may be neccessary to resort to some other rule. As the Supreme Court has pointed out:

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46. Although we have refused to consider value to the taker as a measure of the transferors' compensation, we do take note, as urged by counsel for the PC Trustees, of the spread between the approximately $86 million value placed by MLP on the existing Northeast corridor properties and the $1.6 billion appropriated in Title VII of the Railroad Revitalization and Regulatory Reform Act of 1976, 45 U.S.C. §§ 853, 854, to improve passenger travel time between New York and Boston by 16 minutes and between New York and Washington by 24 minutes. *See* Study of Federal Aid to Rail Transportation, *supra* at VII-14. A spread of this magnitude provides occasion to recall the Supreme Court's frequent iterations that the "word 'just' in the Fifth Amendment evokes ideas of 'fairness' and 'equity' . . . ." *United States* v. *Commodities Trading Corp., supra,* 339 U.S. at 124. *Accord, United States* v. *Virginia Electric & Power Co.,* 365 U.S. 624, 631 (1961); *United States* v. *Fuller,* 409 U.S. 488, 490 (1973).

47. An affidavit of J. Richard Tomlinson, Executive Vice-President of the PC, attached to the opening brief of the PC Trustees indicates that the $685 million figure reflected a large number of zero and negative values. Mr. Tomlinson roughly estimated that some $434 million of negative value had been deducted from the transferors' facilities other than "trackwork." Bridges and terminals are typical of such facilities. While we do not now take a position on the issue, we place the Government parties on notice that substantial proof will be required to convince us of the propriety of deductions for "negative value."

> The Court in its construction of the constitutional provision has been careful not to reduce the concept of "just compensation" to a formula. The political ethics reflected in the Fifth Amendment reject confiscation as a measure of justice. But the Amendment does not contain any definite standards of fairness by which the measure of "just compensation" is to be determined. . . . The Court in an endeavor to find working rules has adopted practical standards, including that of market value . . . But it has refused to make a fetish even of market value.

United States v. *Cors, supra,* 337 U.S. at 332 (citations omitted).

If it should prove impossible to establish a market value which constitutes just compensation, the basis that now seems to us most deserving of serious consideration—whether as the sole basis or as one to be considered along with NLV we need not now determine—is a basis related to original cost. In contrast to most condemnations, the property is not being converted to new uses; ConRail is being substituted for the transferors. In other words, ConRail has been put in roughly the same position it would have occupied had it made the transferors' original investment when they did and depreciated it at the proper rate. Thus, a figure related to original cost may have some relevance to the value of what is being transferred. We use the phrase "related to" since not only must allowance be made for depreciation, but a further deduction might be justified to reflect physical deterioration beyond the point provided by the normal depreciation allowances but not constituting CUE.[48] ConRail is being substituted as the operator of a *deteriorated* railroad. Since ConRail must pay for the deterioration when it rehabilitates the property, the Government should benefit through a deduction in its purchase price (except insofar as the deterioration constitutes CUE). From the standpoint of precedent, use of original cost less depreciation finds

48. The acronym would be OCLD & D.

support in the portion of *PATH* relating to the tunnels. An additional deduction for deterioration would find support in the portion of *PATH* relating to the non-tunnel properties as well as in *In re City of Eureka, supra,* 19 Cal. R.C.D. at 957.

Figures appropriately related to original cost would be entirely "just" to the transferors absent proof of a higher sale value; owners of hopelessly losing properties who are unable to establish a higher net liquidation value would have no just grievance if they receive back their original investment less one or even both of the deductions we have outlined. The Supreme Court's decision in *Roberts* with respect to the easements is authority at least for this. A figure based on original cost has the further advantage of relative ease of determination from records which, except for any deterioration deduction, are readily available in the carriers' reports to the ICC. *See Phillips, The Economics of Regulation* 239 (1965). The Government parties complain that it is not rationally related to the rights of which the transferors have been deprived, and call attention to the portion of Mr. Justice Clark's opinion in *United States* v. *Toronto, H. & B. Nav'n Co.,* 338 U.S. 396, 403 (1949) (footnote omitted), which quoted an economist as saying:

> original cost is well termed the "false standard of the past" where, as here, present market value in no way reflects that cost.

Here, however, we have a case where provable market values may be as inaccurate an indication of just compensation as original cost can be in a more traditional proceeding. And the court was also to say, less than four months after the *Toronto* decision:

> This Court has never attempted to prescribe a rigid rule for determining what is "just compensation" under all circumstances and in all cases. Fair market value has normally been accepted as a just standard. But when market value has been too difficult to find or when its

> application would result in manifest injustice to owner or public, courts have fashioned and applied other standards . . . . Whatever the circumstances under which such constitutional questions arise, the dominant consideration always remains the same: What compensation is "just" both to an owner whose property is taken and to the public that must pay the bill?

United States v. *Commodities Trading Corp, supra,* 339 U.S. at 123 (footnote omitted). While we recognize that this decision, as well as *United States* v. *Cors, supra,* 337 U.S. 325, rejected claims that market value exceeded what the Government deemed to be just compensation, the principle, as stated in the *Commodities Trading* opinion, must work both ways. And what the Government parties regard as a windfall to the owners by an award of more than they can prove to have been obtainable on the market is lessened by the accrual of large prior claims during the lengthy bankruptcy proceedings.

The parties should not read this discussion of original cost to indicate we are bound to it as a factor in valuation. It should be clear that we are not suggesting that a figure related to original cost is the best indication of CMV. Instead, we propose it only as a possible check on shortcomings we fear may develop in the usual valuation method focusing on market values. Furthermore, we would not be surprised to find that revised market value figures were not much different from depreciated original cost. After all, some of the rail property is heavily depreciated and the original cost value of much may be further reduced when deterioration is considered. But in the event a wide disparity should exist, we may not be able to accept as fair any valuation which does not reflect an adjustment related to original cost or a better check on fairness that the parties may suggest. We thus place the parties on notice that we may feel obliged to resort to some kind of analysis related to original cost and that they should present evidence accordingly.

We should also advise the parties, in the interest of their avoiding the expense incident to complex engineering studies, that we do not intend to consider estimates of reproduction cost, variations on that theme such as "assemblage value," value of materials "in place," trended original costs, gross liquidation value or societal values.[49] All these concepts suffer from the basic defect that they are neither values which the transferors were in a position to realize at the time of the taking nor an amount deriving from what they had invested so that there may be some fair claim to having it returned if other methods of arriving at just compensation should fail.[50]

This obviously is not a case where reproduction cost evidence should be receivable on a theory of indemnity, *i.e.*, finding the amount the taker should pay to enable the condemnee to reestablish his business elsewhere, as in the *Foley Square* case, 306 F.2d at 448-49, discussed above, since that is something which the transferors do not wish at all. The transferors' assertion of a

49. In this portion of this opinion we shall sometimes use the term "reproduction cost" to embrace these other theories as well.

50. The PC lienholders assert that failure on our part to take account of reproduction cost would discourage investment in railroads or other public utilities. This is a combination of what Professor Bruce Ackerman, in analyzing utilitarian arguments for just compensation, has called the Appeal to General Uncertainty and Citizen Disaffection. *See Private Property and the Constitution, supra* at 44, 49. However weighty such arguments may be in forbidding an award that would be a mere pittance because of insuperable difficulties in establishing fair market value, we fail to see how they support consideration of reproduction cost. No one buys a railroad's bonds or stocks in the expectation that the road will become bankrupt or that the government will take it over if it does. Still less could investors have expected that in such events the Government would pay many times what could have been obtained by way of a sale or what it had cost to build the railroad in the first instance. All that can be said is that investors in railroad securities reasonably expect that if their property should be taken, they, like all other property owners, will be treated fairly. Applying Professor Ackerman's formula that under the utilitarian view compensation should be given when and only when $P < U + D$, where P = process costs, U = uncertainty costs and d = the costs of citizen disaffection, p. 48, the test plainly would not be met if P were influenced by reproduction cost. Indeed, there might be citizen disaffection over the payment of what would seem a grossly excessive amount.

right to present reproduction cost evidence is based rather on a theory of value to the taker or on some reified notion of property, concepts which we have rejected earlier in this opinion.

Although the transferors have not said what RCNLD would amount to, it is clear that the figures would be tremendous. To take one example, the Penn Central estimated its RCNLD as of December 31, 1970, as some $13 billion as against December 31, 1975 book value of $3.6 billion, FSP, Vol. I, at 142; as a result of inflation the disproportion would probably be greater today. EL estimated its RCNLD as of December 31, 1973, as some $3.6 billion as compared to a book value of $318 million. *Id.* While we understand these figures relate to the entire estates (including non-operating properties) and not simply to the portions transferred, the disproportion remains significant. The railroads in the eastern district have not earned a rate of return on *book value* as high as 4% for the past dozen years; the rates of return for the years ending March 31, 1968, 1969 and 1970 were 1.51%, 1.33% and .37%. *See* The American Railroad Industry: A Prospectus 48 (America's Sound Transportation Review Organization 1970). Moreover, since the Supreme Court's decision in *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), the railroads are not even *entitled* to earnings constituting a fair return on a reproduction cost rate base; the ICC permissibly uses a net investment value rate base. *Net Investment-Railroad Rate Base & Rate of Return,* 345 I.C.C. 1494, 1514-42 (1976). *See also* Note, *Con-Rail and Liquidation Value: Creditors' and Stockholders' Entitlement in the Regional Rail Reorganization,* 85 *Yale L.J.* 371, 375 (1976). It would be a strange notion of "just compensation" that would require the taxpayers to pay so much more for these properties in their deaths than they had been worth during their recent lives. On this point we find *Market Street Railway, supra,* 324 U.S. at 567, although a rate case under the due process clause rather than a condemnation case under the just compensation clause, to be very nearly decisive.

Apart from these basic conceptual defects, resort to reproduction cost as a measure of value in a case like this would lead into a never-never land where this court and the parties would perforce spend long years in the quest of a goal that is unattainable and not worth attaining.

In the first place, despite the deceptive simplicity of the terms, no one knows what RCNLD means. Hartman's book on *Fair Value* at 100 (1920) more than a half-century ago noted that attempts to define the term had developed along three general lines: (1) the cost of reproducing a plant similar in all essentials to the existing plant, under present conditions; (2) the cost of reproducing a similar plant at present prices, under conditions prevailing at the time of original construction; (3) the cost of constructing a substitute plant capable of performing the same service. *Hartman, supra,* at 100. The list is not exhaustive. *See Bonbright* at 152: *Phillips, supra,* at 241-42. Under any of the approaches, the reproduction cost figure would have to be depreciated on some basis to reflect the age and also the deteriorated condition of the present plant, except so far as deterioration might constitute CUE; there would surely be no fairness in taking the cost of building a plant to provide efficient "substitute service" when, due to chronic undermaintenance, the existing service was far below the service of which the older technology was capable. Also, under the circumstances here, there would seem to be no reason for theorizing the construction of a plant "capable of performing the same service" when there is not and may never be a demand for that service; one of the reasons for the transferors' plight has been the underutilization of their plant, *see* PSP, Vol. I, at 4, and there is no assurance that this has been fully remedied by FSP, which was necessarily a compromise to some degree. *See, e.g.* FSP, Vol. II, at 2-5 (light density lines).

Perhaps enough has already been said to illustrate the interminable debate among engineers and other experts which any attempt to arrive at the reproduction cost of the properties here at issue would engender. The experts and ultimately this Court

would have to sort out the various senses in which one can "reconstruct" a railroad. Is one required simply to provide service between cities, or does "reconstruction" entail the duplication of all existing spur connections to industrial shippers, although they could reach the main line more efficiently by truck? Would the substitute service have to be equivalent to existing service, with slow orders of 10 m.p.h. on much of the track, or would it have to be the equivalent of the service that would have been offered by a well-maintained version of the former railroad? In computing the cost of land for track, freight yards and terminals, must one assume use of the existing sites, or may cheaper ones be substituted? On either view, is one to take account of increased land values due in part to the presence of the railroad and in part to the efforts of others; or is one interested in what it would cost to reconstruct a railroad if the existing ones had never existed?

These definitional difficulties are augmented by additional problems of calculability. While some of these have been anticipated in our discussion, further elaboration may be useful. Perhaps the most difficult question is how to make allowance for functional depreciation. Mr. Justice Brandeis thought that functional depreciation should encompass not only "progress in the art of rail transportation" which has reduced the value of the existing plant. *St. Louis & O'Fallon Ry.* v. *United States*, 279 U.S. 461, 523 (1929) (Brandeis, *J.*, dissenting) but also changes in the volume or character of a railroad's traffic or in the nature of the community it serves that would lead to alteration in rail system design if the railroad were to be rebuilt. *See also* 2 *Orgel* at 111; *Bonbright* at 161, 168, 215.

The uncertainties in calculating functional depreciation are rivalled by the difficulties of arriving at the initial estimate for RCN. In his *O'Fallon* dissent, Mr. Justice Brandeis noted, in terms fully applicable here, that "there was practically no construction of new lines" during the recapture years there in question, making it very difficult to estimate current construction costs; on the other hand, indexing construction costs from earlier

years was unsatisfactory since it gave no effect to new cost-saving methods of construction, 279 U.S. at 544-45. *See also Missouri ex rel. Southwestern Bell Telephone Co.* v. *Public Service Comm'n*, 262 U.S. 276, 299-300 (1923) (Brandeis, *J.*, dissenting); *Bonbright* at 166-67.

Commissioner Eastman of the ICC also considered that RCN estimates were unreliable, for they were "based on all manner of assumptions, and invade the realm of fancy at numerous points." He cited, as one example, not without applicability here, that the estimate of RCN for a given segment of railroad would depend on how many other railroads were hypothetically being reproduced, since it is more expensive to construct a railroad if no other railroads are available for the transport of construction materials. *San Pedro, Los Angeles & Salt Lake R.R.*, 75 I.C.C. 463, 530 (1923) (dissenting opinion), *modified*, 103 I.C.C. 398 (1925).[51]

Another type of objection to RCN as a valuation method is based at root on considerations of equity. RCN under prevalent methodology would take no account of the fact that the original construction of the railroad was done in a timely fashion. In regard to land, for instance, basing the value on the current market price of adjoining land would amount to positing the reconstruction of the railroad with the least efficient timing possible in the development of an industrial area. *See San Pedro, Los Angeles & Salt Lake R.R., supra*, 75 I.C.C. at 549. Judging the RCN of land by the current value of adjoining real estate has in addition the unwarranted effect of penalizing state and local governments for public improvements undertaken by them. The increased value of the land on which a railroad has been built is the result not simply of the construction of the railroad but of what the New York Court of Appeals has recently termed "the massive and indistinguishable public, governmental and private contributions," *Penn Central Transportation Co.* v. *New York*

51. *See also* 1 *Kahn, The Economics of Regulation: Principles and Institutions* 39 (1970), *quoting* 2 *Lyon & Abramson, Government in Economic Life* 691 (1940).

City, ___ N.Y.2d ___, ___, ___ N.Y.S.2d ___, ___ (1977).

Finally, it is hard to see why investors, and particularly bondholders in bankrupt railroads, should enjoy a bonus for the effect of inflation not accorded to most other citizens. Commissioner Eastman inquired in his *San Pedro* dissent, 75 I.C.C. at 532:

> [W]hy should public utility investors be constituted a favored class exempt from the hardships suffered by other investors due to the change in the purchasing power of the dollar?

See also Mr. Justice Brandeis in *Southwestern Bell, supra*, 262 U.S. at 305, 307. While in fixing rates for operating utilities it may well be necessary to take appropriate account of the increased cost of replacing facilities constructed at substantially lower prices, there is no corresponding consideration here.

The difficulties in the use of RCNLD are not decreased by the suggestion of some of the transferors, apparently embarrassed at the size of the award on a reproduction cost theory alone, that we need not take RCNLD as "the value" but simply as a factor to be considered along with OCLD and NLV in arriving at value. Rather they are augmented. As Commissioner Eastman noted in his *San Pedro* dissent, it is one thing to apply RCN as a check on estimates of OC when the range between the two is narrow, but is a quite different thing when a long period of price change has produced a vast difference between the two. Under such circumstances the choice of a figure becomes increasingly arbitrary. 75 I.C.C. at 553-54.[52]

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52. Commissioner Eastman stated:

> I must confess that it seems to me that unless some definite standard can be found for determining the weight to be given to such widely conflicting evidence, the process of valuation will become arbitrary to a degree wholly impossible to defend. Value will become a speculative and capricious matter, varying millions of dollars upon exactly parallel sets of facts, dependent upon the

We are told that, however all this may be, authority compels us to plod into the morass of taking evidence on RCNLD "for whatever it may be worth"—the hope being apparently that a decade hence, when this job has been completed,[53] we—more accurately, our successors—will have a different perception of the bearing of such figures than we do now. We have already discussed and rejected the lines of authority that are most nearly pertinent although not sufficiently so as to be persuasive. Only a little more needs to be said.

One line of cases, cited to us not as binding authority but as "an instructive analogy to the present valuation task", Reply Brief of Intervening PC Lienholders at 42-47, consists of decisions of the ICC under § 3(5) of the Interstate Commerce Act:

> If the Commission finds it to be in the public interest and to be practicable, without substantially impairing the ability of a common carrier by railroad owning or entitled to the enjoyment of terminal facilities to handle its own business, it shall have power by order to require the use of any such terminal facilities, including main-line track or tracks for a reasonable distance outside of such terminal, of any common carrier by railroad, by another such carrier or other such carriers, on such terms and for such compensation as the carriers affected may agree upon, or, in the event of a failure to agree, as the Commission may fix as just and reasonable for the use so required, to be ascertained on the principle controlling compensation in condemnation proceedings.

49 U.S.C. § 3(5).

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bent of mind, temper, and perhaps, digestion of the particular individuals who happen to exercise the "judgment."

Id.

53. We are quite serious about the time estimate. The ICC's valuations of the country's railroads under § 19a of the Interstate Commerce Act required 19 years. *See* III-A *Sharfman, The Interstate Commerce Commission* 39-40 (1935).

Appendix E

The leading decision under § 3(5) (at the time, § 3(4)) is *Missouri-Kansas-Texas R.R.* v. *Kansas City Terminal Ry.*, 198 I.C.C. 4 (1933) (*MKT*). The Commission there sought to fix the compensation to be paid to Kansas City Terminal (KCT) for MKT's use of portions of the terminal facility. The Commission first disposed of preliminary contentions, ruling that since MKT was in effect a tenant, just compensation could be in the form of rental payments, rather than in a lump sum. The Commission also directed MKT to pay a rental based on its numerical share (as one of 12 users of the property) rather than on a user basis. Moving to the determination of the fair value of the property, the Commission discussed the valuation principles it thought applicable:

> Before proceeding to discuss the evidence and our conclusions relative thereto, we repeat it is our interpretation of the statute that the principles controlling compensation in condemnation statutes are fully applicable and appropriate to determine the value of the property for the use of which compensation is to be made. Insofar as the rules, methods, and principles laid down by us in our valuations under section 19a of the act are applicable, we shall be controlled thereby. At the same time we recognize the distinction between the controlling principles applicable for the ascertainment of values for rate-making purposes and those applicable in condemnation cases. We do not perceive, however, why the principles applicable for the determination of individual elements, such as cost or reproduction, cost of reproduction less depreciation, and original cost, should be any different in the instant case from those in the rate-making case. It is true that certain facts—earnings for instance—may be relevant in condemnation cases while irrelevant in rate-making cases, but if the facts are relevant the controlling principles in their ascertainment should be the same.

198 I.C.C. at 14.

This seems to us little more than saying that the Commission proposed to apply its *San Pedro* and *O'Fallon* decisions concerning the factors to be taken into account in valuation for ratemaking purposes under § 19a as a guide for its decisions under § 3(5). *See also* III-A *Sharfman, supra,* at 124 (noting that § 19a was "a statutory replica [of] *Smyth* v. *Ames*"). The undermining of *San Pedro* and *O'Fallon* by the Supreme Court's decision in *Hope Natural Gas* deprives *MKT* and its progeny, including cases that applied *MKT* in fixing fair and equitable terms and conditions for acquisitions under § 5(2), *e.g., Use by Erie R.R. of Niagara Junction Railway Terminals,* 278 I.C.C. 425 (1950), of any precedential authority for us.

The Brief of the PC Lienholders at 161-62 & n.145, also tells us that "In public utility condemnation cases the reproduction cost of the facility is invariably a significant measure of value," and that "Reliance on reproduction cost is common in federal and state courts." Some of the cases cited are ratemaking cases, which must be deemed to have been overruled by *Hope Natural Gas, see Market Street Railway, supra,* 324 U.S. at 566-68. One of the condemnation cases cited is *PATH,* which, as we read it, gave no weight to reproduction cost for the losing tunnel properties. Another is *Fifth Avenue Coach.* We have declined to follow that case in other respects; moreover, whatever authority it might have lent to the use of reproduction cost in valuing an unprofitable utility is undermined by the subsequent decision of the same court in *PATH.* One case cited, *In re City of Oroville, supra,* [1922E] P.U.R. at 469-70, quite clearly rejected RCN and RCNLD. Still other cases have been discussed in Part IV(A)(5) of this opinion.

More clearly inapplicable are cases in which there is no indication that the utility was hopelessly unprofitable, *City of Omaha* v. *Omaha Water Co.,* 218 U.S. 180 (1910); *Albert Hanson Lumber Co.* v. *United States,* 261 U.S. 581 (1923); *Wichita Water Co.* v.

City of Wichita, 271 F. 973 (D. Kansas 1921), *rev'd*, 280 F. 770 (8 Cir. 1922), *City of Baxter Springs* v. *Bilger's Estate*, 110 Kan. 409, 204 P. 678 (1922), or in which it is clear from the opinion that the condemned utility was profitable or likely to become so. *National Waterworks Co.* v. *Kansas City*, 62 F. 853 (8 Cir. 1894); *United States* v. *Boston, Cape Cod and N.Y. Canal Co., supra*, 271 F. 877; *Puget Sound Power and Light Co.* v. *Public Utility Dist. No. 1*, 123 F.2d 286 (9th Cir. 1941), *cert. denied*, 315 U.S. 814 (1942); *City of Phoenix* v. *Consolidated Water Co.*, 101 Ariz. 43, 415 P.2d 866 (1965); *Dade County* v. *General Waterworks Corp.*, 267 So.2d 633 (Fla. 1972); *Kennebec Water Dist.* v. *Waterville*, 97 Me. 185, 216, 54 Atl. 6, 19 (1902); *Montgomery County* v. *Schuykill Bridge Co.*, 110 Pa. 54, 20 Atl. 407 (1885); *Borough of Hanover* v. *Hanover Sewer Co.*, 251 Pa. 95, 96 Atl. 132 (1915); *Appleton Waterworks Co.* v. *Railroad Comm'n, supra*, 154 Wis. 121, 142 N.W. 476. RCNLD may be a tenable measure of the value of the opportunity to continue a profitable enterprise, as we have noted, but it has no relevance here.

Beyond this, many of these cases stem from the heyday of *Smyth* v. *Ames* and even more extreme Supreme Court decisions extolling the role of reproduction costs in public utility valuation for rate-making purposes, *e.g.*, *McCardle* v. *Indianapolis Water Co.*, 272 U.S. 400 (1926). It is natural that this should have had a spillover into public utility condemnation; and when the utility was a profitable one, earning a return on a RCNLD rate base, reference to RCNLD as a factor would have been not only natural but perhaps defensible, see the remarks of later Chief Justice Taft as a dissenting arbitrator in *Grand Trunk Ry.* v. *Rex*, [1923] A.C. 150, 162-63 (Privy Council) and *Bonbright* at 156, although it is hard to see just what evidence of RCNLD added to the capitalization of earnings upon it that would have gotten to the point more directly, *see* 2 *Orgel* § 210, at 89. The remarks in 2 *Orgel* § 210, at 88 and in *Bonbright* at 151 and 153 can be

similarly explained; neither asserts that replacement costs must be considered in the condemnation of a losing public utility.

In sum, the time has come "to lay the ghost of *Smyth* v. *Ames*," *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 602 (1942) (Black, Douglas and Murphy, J.J., concurring), not only in ratemaking but, to such extent as it has lingered there, in eminent domain, except under such special circumstances as existed in the *Foley Square* case, *supra*, 306 F.2d at 447-48, and in the cases involving condemnation of property not held for profit. Reproduction cost evidence should be received in condemnation proceedings only when, as in such cases, it affords needed assistance to a court in finding what will be an appropriate indemnity for an owner wishing to continue to devote his property to its existing use. That, as we have several times pointed out, is not this case. We thus will not permit the masters to take evidence on reproduction cost, assemblage value, value of materials "in place," trended original cost, gross liquidation value or societal values unless a particular transferor can bring himself within the principal of *Foley Square*.[54] While the transferors are free to make offers of

54. We also reject the contention that the transferors are entitled to an allowance for the "going concern" value of their properties despite their unprofitability. Most of the cases cited which allow compensation for going concern value involve profitable utilities, *e.g.*, *National Waterworks Co.* v. *Kansas City*, *supra*, 62 F. at 865, *City of Phoenix* v. *Consolidated Water Co.*, *supra*, 101 Ariz. at 46, 415 P.2d at 869; *Dade County* v. *General Waterworks Corp.*, *supra*, 267 So.2d 633; *Brunswick & T. Water Dist.* v. *Maine Water Co.*, 99 Me. 371, 376, 59 Atl. 537, 539 (1904); *Borough of Hanover* v. *Hanover Sewer Co.*, *supra*, 251 Pa. at 99, 96 Atl. at 134; *Oshkosh Waterworks Co.* v. *Railroad Comm'n*, 161 Wis. 122, 131, 152 N.W. 859, 863 (1915). One case, *City and County of San Francisco* v. *Pacific Gas & Electic*, [1929E] P.U.R. 529 (Cal. Railroad Comm'n 1929), concerned property taken from a company that continued in business. In another decision, which did involve an unprofitable utility, In re *Fair Oaks Irrigation Dist.*, *supra*, [1918C] P.U.R. at 884, the California Railroad Commission noted only that it would give some consideration to net earnings, of which the utility had none.

We have already indicated our disagreement with the holding of *Fifth Avenue Coach*, *see* pp. 56-57, *supra*. To the extent that *PATH*, *supra*, 20 N.Y.2d at 471-72, 285 N.Y.S.2d at 33, followed that decision with respect to going concern value, we disagree with it as well. As Judge

proof on any or all of these themes, we strongly suggest that they curtail expenditures on such studies to the minimum needed to enable them to make intelligible offers of proof; in turn, we shall not fault them for any deficiencies in the offers resulting from such a curtailment.

V. *Sales to Other Public Bodies*

In this section we deal further with the argument of the Government parties that the alternative scenario may not include sales to other public bodies or, at minimum, may not include sales to such bodies by way or in lieu of condemnation. We have previously indicated in Part III that, as a matter of statutory construction, we see no reason why such sales should not be includible in determining NLV; however, that would serve little purpose if they were required to be excluded for purposes of determining CMV.

In this Court's June 16, 1976 Memorandum, we requested briefing on the question whether, in determining NLV under § 306, account should be taken of potential rail use sales at prices greater than nonrail NLV "when the proposed sale is to a public body vested with the power of eminent domain, in the absence of proof of a private purchaser ready and willing to make the purchase?" 425 F. Supp. at 283. The consequent briefing centered on one aspect of that question: whether any such public (or private) purchasers would in fact pay more than salvage value, with the Government parties arguing that they would not in light of the claimed ability and policy of the ICC to condition permission to abandon with a "salvage value clause" requiring the applicant to sell for continued operation at not less than net salvage value. We indicated in our October 18, 1976 Opinion that we were not persuaded by the Government's contention that such clauses had any effect other than that, as between two purchasers

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Burke observed in his *PATH* dissent, "Economic viability, i.e., the capacity to operate at a profit, is . . . the *sine qua non* for an award of going concern value." *Id.* at 480-81, 285 N.Y.S.2d at 40-41.

neither of which was willing to pay more than scrap value, the railroad must prefer the one that would continue operations, and that the willingness of a public body, even in the absence of competition, to pay more than scrap value, was a matter of proof, *see* 425 F. Supp. at 271-73. We now reaffirm that initial conclusion, along with our rejection, *id.*, of the Government's broader assertion that ICC regulation in the absence of the Act would and could have reduced the price for all rail use dispositions to nonrail NLV; *see* pp. 31-32 & n.19 *supra.*

As a result, another aspect of the question of sales to public bodies, previously somewhat obscured by the controversy over the salvage clause, becomes significant. This is whether, assuming that public bodies would in fact pay more than salvage value, it is permissible as a matter of condemnation law to include them in the market. The Government parties claim that, absent a showing that the purchase would have been made in the expectation of profitable operation, it is not. The argument is that consideration of state and local governmental bodies as purchasers, *first,* would run contrary to the eminent domain principle that even actual increases in private market value are not compensable if attributable to the same public project for which the property was taken, and *second,* that taking account of such prospective purchasers would unacceptably burden the exercise of federal power.

The Government's invocation of the "same project" limitation on actual market value as of the time of the taking is unavailing. We follow the Government parties in their claim that any increases in market value resulting from the *taker's* project are to be excluded in computing the amount the taker must pay. *See Shoemaker* v. *United States,* 147 U.S. 282, 303-05 (1893); *United States* v. *Miller, supra,* 317 U.S. at 375-77; *United States* v. *Cors, supra,* 337 U.S. at 332-34. But the putative interest of a public body in acquiring properties for continued rail use is independent of the effort by the Federal Government, the taker in this case, to secure such a continuation through the Rail Act. The proposition that a condemnee is not entitled to compensation for

demand attributable to the taker's very project does not compel the conclusion that he is not entitled to value for uses for which other condemnors would have paid in order to serve the same purpose—preservation of rail service—as is served by the actual taker's project;[55] to employ the "same project" vocabulary is only to state the public sales issue here under consideration in another way.[56]

The Government's reliance on the decision in *United States* v. *124.21 Acres of Land*, 458 F.2d 568 (8 Cir. 1972), on this score is misplaced. The court there indicated that demand for borrow material created by the interstate highway project for which the material was taken by the Federal Government may not be considered. It refused to consider as market value prices previously paid by the state of Minnesota for such material, apparently because that purchase also had been for use on the same highway construction. Exclusion of the state's purchase on this ground was simply an unexceptional application of one aspect of the same project doctrine; unlike the issue here with respect to purchases by public bodies, Minnesota's demand for the fill dirt was a direct result of the project of the federal government, the taker.

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55. This distinction is not called into question by application of the "same project" rule to a federal taking for the use of a local government, *see United States* v. *First Pyramid Life Ins. Co.*, 382 F.2d 804, 806-07 (8 Cir. 1967), or to situations involving related condemnations by the federal government and a state, *compare United States* v. *137 Acres of Land*, 406 F.2d 1283 (6 Cir. 1969), *with United States* v. *390.71 Acres of Land*, 352 F. Supp. 735 (E.D. Ill. 1972).

56. We do note that, wholly apart from the necessity of excluding from the alternative scenario other possible federal responses to the rail crisis, the reasoning of the "same project" cases would require the exclusion of public sales whose likelihood is premised on a federal taking of other rail properties (for example, of connecting lines), for in such a case the amount to be paid by the taker would be increased by demand for which his taking was a necessary condition. And we again note that proof of public sales will have to contend with "[the Government's] claim that a state would not be interested in making the substantial payments required for taking over main line (as distinguished from commuting) operations without assurance that other states would take similar action to the extent required to constitute a viable system." October 18 Opinion, 425 F. Supp. at 273 n.5.

Such Supreme Court opinions as exist lend support to the proposition that other potential condemnors may be considered, although the Court's discussion has not been altogether clear. The lack of clarity is largely due to the fact that the cases, like those dealing with inclusion of the taker in the market, *supra*, Part IV, generally deal also with a separate issue—whether a condemnee is entitled to values that could be realized only if his property were united with those of others. The general answer is that when this could be accomplished only by someone's exercise of eminent domain, he is not. *See McGovern* v. *New York*, *supra*, 229 U.S. 363; *City of New York* v. *Sage*, *supra*, 239 U.S. 57; *United States ex rel. Tennessee Valley Authority* v. *Powelson*, *supra*, 319 U.S. at 275-79. *See also In re Bensel*, 230 F. 932 (S.D.N.Y. 1916) (remand of *Sage*) (L. Hand, J.). This follows logically from the rule which excludes value to the taker, as such land has assemblage value only to a taker with eminent domain power, not to a seller who lacks such power.

Probably the leading case on the inclusion in the market of public bodies other than the taker is *Olson* v. *United States*, *supra*, 292 U.S. 246. The Court there considered whether reservoir use was relevant to the just compensation owed for a taking of certain flowage easements.[57] In the course of affirming the exclusion of reservoir use on the ground that such use was insufficiently probable absent the taking, the Court said, 292 U.S. at 256:

> . . . The fact that the most profitable use of a parcel can be made only in combination with other lands does not necessarily exclude that use from consideration if the possibility of combination is reasonably sufficient to affect market

57. Although the condemnation statute there provided for compensation in accordance with the constitution of Minnesota, 292 U.S. at 250, the Court noted that the standard "is not, at least so far as concerns these cases, to be distinguished from that expressed by the just compensation clause of the Fifth Amendment and implied in the due process clause of the Fourteenth Amendment to the Federal Constitution," *id.* at 254.

> value. Nor does the fact that it may or is being acquired by eminent domain negative consideration of availability for use in the public service. *New York* v. *Sage*, 239 U.S. 57, 61. It is common knowledge that public service corporations and others having that power frequently are actual or potential competitors, not only for tracts held in single ownership but also for rights of way, locations, sites and other areas requiring the union of numerous parcels held by different owners. And, *to the extent that probable demand by prospective purchasers or condemnors affects market value, it is to be taken into account.* (Emphasis supplied.)[58]

Although the opinion thus referred to the "most profitable use" of the property, the Government parties' effort (Government Br. at 254-55 n.299) to limit the Court's language to cases where public buyers are looking to the profitability of the property in question is unpersuasive since it seems more likely that the Court meant only to refer to the idea of most advantageous use in the sense of that yielding the highest price to the condemnee. The actual holding that reservoir use was too speculative, 292 U.S. at 260, was based rather on the Court's conclusion that the condemnee had not sustained the burden of showing that in fact there were other potential purchasers or condemnors for reservoir use.

The opinions in *United States* v. *Miller, supra*, 317 U.S. 369, and *United States* v. *Cors, supra*, 337 U.S. 325, also contain language suggesting that other public bodies vested with the condemnation power may be included in the market. In *Miller*, the Court said, 317 U.S. at 375:

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58. The Court here cited *Boom Co.* v. *Patterson, supra*, 98 U.S. 403, where an award including use of the condemned property for boom purposes was upheld on the ground that such use was available to persons other than the taker, although the opinion seemed to assume that adaptation for boom use would not require an exercise of eminent domain by the supposed other users and did not indicate whether such users included public bodies. *See* 98 U.S. at 408-09, and the discussion of the case in 1 *Orgel* § 90, at 376.

> [A]lthough the market value of the property is to be fixed with due consideration of all its available uses, its special value to the condemnor *as distinguished from others who may or may not possess the power to condemn,* must be excluded as an element of market value. (Footnotes omitted, emphasis supplied.)

See Note, *supra,* 90 *Harv. L. Rev.* at 600 n.20. To the same effect, the *Cors* Court stated, 337 U.S. at 333:

> The special value to the condemner *as distinguished from others who may or may not possess the power to condemn* has long been excluded as an element from market value. (Emphasis supplied.)

In both instances, the Court cited *United States* v. *Chandler-Dunbar Co., supra,* 229 U.S. at 76-77, where value for lock and canal use was included:

> The exception taken to the inclusion as an element of value of the availability of these parcels of land for lock and canal purposes must be overruled. That this land had a prospective value for the purpose of constructing a canal and lock parallel with those in use had passed beyond the region of the purely conjectural or speculative. That one or more additional parallel canals and locks would be needed to meet the increasing demands of lake traffic was an immediate probability. This land was the only land available for the purpose. It included all the land between the canals in use and the bank of the river. Although it is not proper to estimate land condemned for public purposes by the public necessities or its worth to the public for such purpose, it is proper to consider the fact that the property is so situated that it will probably be desired and available for such a purpose. Lewis On Eminent Domain, § 707.

Boom Co. v. *Patterson*, 98 U.S. 403, 408; *Shoemaker* v. *United States*, 147 U.S. 282 . . . .

The *Miller* and *Cors* Courts apparently read this not as a departure from the general rule against taking account of value to the taker but as indicating that value for the same *purpose* as the taker's to other purchasers or condemnors is includible.[59]

Despite all this we find appreciable force in the Government parties' argument that considering other public purchasers might threaten the ability of the federal government to solve national problems through use of the condemnation power whenever the problem also impacts at the state and local level—a point which does not appear to have been brought to the Supreme Court's attention in any of the cases we have discussed. The effective result of including such purchasers in the market, the Government says, would be that despite the disallowance of "hold up" value when considering the condemnee-federal condemnor relationship, we would then allow a similar "hold up" to enter the calculation of just compensation through the back door of hypothetical dispositions to other public bodies. It is not a sufficient answer to say that doing this does not bar the federal government from resort to condemnation solutions but affects only the just compensation figure. (*See* EL reply brief at 13.) If a state or

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59. To be sure, that portion of *Chandler-Dunbar* has been narrowly confined, *see United States* v. *Twin City Power Co.*, 350 U.S. 222, 226-227 n*. (1956); *United States* v. *Rands*, 389 U.S. 121, 126-27 (1967), though not so as to exclude consideration of other public purchasers.

There is one oddity here. Aside from relying on *Boom Co.* v. *Patterson*, discussed in note 59, *supra*, the *Chandler-Dunbar* Court's supporting discussion of *Shoemaker* v. *United States*, *supra*, 147 U.S. 282, shows that the Court thought *Shoemaker* had approved an instruction that if the taken property "'is peculiarly adapted to some particular use—e.g., to the use of a public park—all the circumstances which make up this adaptability may be shown, and the fact of such adaptation may be taken into consideration in estimating the compensation,'" *see* 229 U.S. at 78, while in fact *Shoemaker* approved the refusal to give that instruction. *See Shoemaker*, *supra*, 147 U.S. at 304-05; 1 *Orgel* at 364-65.

local government, by an improvident arrangement with the condemnee, could dictate what the Federal Government must pay for its decision to condemn, the federal condemnation power would in some degree be hostage to those levels of government.

The problem is sufficiently troubling that we think it preferable, before attempting anything like a complete resolution, to await factual development which will enlighten us as to the true dimensions of the issue. The Government is clearly entitled to be protected against prices that would represent simply the appraisal of a state or local body of how much it would pay under duress rather than have service cut off. Payment of any such price would be unreasonable. The state and local bodies themselves had or could readily have been given the power of eminent domain, including power to take title without contemporaneous payment so long as they recognized "the absolute right of the owner, upon his property being taken, to just or reasonable compensation therefor, and [made] provision . . . for the ascertainment . . . of the compensation to which, under the constitution, he is entitled." *Sweet* v. *Rechel*, 159 U.S. 380, 404 (1895). Value to the taker should no more be admissible in state than in federal condemnation. Also, under the special circumstances of this case, the Federal Government should not be deemed a potential buyer in a hypothetical state or local condemnation; Congress was clearly willing to bow out if state or local bodies would come in. Beyond that we deem it best to rest for the present on what we have previously said, 425 F. Supp. at 273.

VI. *Severance Damages*

Our June 16, 1976 order requested briefing and argument on the issue whether compensation was due for "any diminution in value of the assets severed and then left with the transferors, on a theory of inverse condemnation or otherwise." 425 F. Supp. at 287.

To no one's surprise the transferors answer in the affirmative, referring to 4A *Nichols, supra* § 14.231 and the many authorities

there cited. While asking that we endorse this general proposition, the PC Trustees consider that it would be unwise for us to go further at this time since the method for computing severance damage may vary according to the general theory of valuation that is adopted.

Not disputing the general principle advanced by the transferors, the Government parties urge that it can have little or no application in this case since the condemned rail properties have been taken for continued rail use. Accordingly "[W]hat was railroad property stays in rail use, and what was railroad frontage remains railroad frontage after the Government has acted." (Govt. brief at 239). It follows, they say, that "any 'severance damage' claim must be based on an allegation that retained properties could have been combined with transferred properties to produce greater aggregate value in the absence of the Rail Act" (Govt. brief at 242) and that all this will be reflected in "the alternative scenario."

While the formulation of the Government parties may cover most of the instances of severance damage, we are not satisfied that it would cover all. Moreover, to insist that all claims of severance damage should be handled by the alternative scenario approach might well put an undue strain on this already heavily burdened device. If a transferor prefers to attempt to establish severance damage on a parcel-by-parcel basis, we do not now perceive any reason for preventing this.

However, we agree that for us now to say more would be premature. We therefore content ourselves with the statement that we see nothing that should prevent application of the principle of severance damage in this case.

VII. *The New Haven*

In our June 16, 1976 memorandum we asked for briefing and argument on a "question raised by the statement of the New Haven Trustee, whether there is any requirement that the properties conveyed by the New Haven to PC should be valued on any

higher basis than other properties," 425 F. Supp. at 287, and allowed the Trustee to intervene "for the limited purpose of presenting contentions pertaining *specifically* to properties transferred by the New Haven estate to Penn Central." *Id.* at 288. (Emphasis supplied). Disregarding this limitation, as he had in his brief on CUE, counsel for the New Haven Trustee has filed a brief and reply brief totaling 104 pages, in which the only specific reference to the New Haven is a conclusory statement in a footnote:

> ". . . the findings of the Supreme Court with respect to value of the New Haven properties established the net salvage value of those properties as of December 31, 1966, and, after proper adjustment to date of conveyance to ConRail, set an absolute floor on the salvage value of the New Haven properties in these proceedings." Br. at 4 n.4.

We agree with the Government parties that the former New Haven properties should not be valued differently in these proceedings simply because they were the subject of valuation at the time of their sale to Penn Central. As previously noted, note 42, *supra,* that valuation stemmed from an agreement between Penn Central and the NH Trustees. While the Government was a party to the *New Haven Inclusion Cases,* its interest was that of supporting the ICC's orders and was not that of a condemnor. Moreover, what was there determined was the liquidation value of the entire NH as of December 31, 1966; the question here is the value of what remained of a portion of those properties,[60] after further physical deterioration, as part of the Penn Central on April 11, 1976.[61] We shall expect the NH Trustee in the future to observe the limitation placed on his intervention; indeed, we see

60. One of the most important assets conveyed by the New Haven to PC, its interest in "the Park Avenue properties" in New York City, was not conveyed in 1976.

61. It goes without saying that we intimate no view as to how the claims of the New Haven Trustee against Penn Central are to be treated by the Penn Central reorganization court.

little need for his further participation in these general proceedings as distinguished from proceedings relating specifically to former NH properties.

VIII. *Value of Other Benefits (VOB)*

In Part IV of our Memorandum of June 16, 1976, 425 F. Supp. at 284, we directed USRA to file a more detailed explanation and calculation of VOB than was contained in the FSP, with the hope that this would enable us to rule on issues of principle and thereby reduce the need for further discovery or factual presentations. As noted at the beginning of this opinion, after this statement was filed we fixed a briefing schedule which permitted the VOB problem to be brought on for argument at the same time as the other issues dealt with in this opinion.

The December 1, 1976 Statement of the Government parties gave this subject a turn we had not expected. Departing from the analysis in FSP, Vol. I, pp. 128-34, the Government parties drew a sharp distinction between what their VOB claims would be under the alternative constitutional claims they assert the transferors are entitled to make: First, "they are entitled to assume the *presence* of the Rail Act" and to claim a right to withdraw *all* their properties from rail use. Value is calculated using the MLP. Second, "they are entitled to assume the *absence* of the Rail Act, and try to establish the values they could have attained by liquidating the transfered properties, for rail *or* non-rail use . . . ," under an alternative scenario.[62] Statement at 5 (emphasis added).

Under the first hypothesis the Government's VOB claims are limited to two categories: One is a "technical adjustment" for part of the enhancement in value of a portion of a retained parcel of

62. The Statement made no attempt to analyze what the Government's VOB claims would be on other valuation theories urged by the transferors, saying only that "VOB would, of course, be present on all such theories." P. 2 note *.

land by virtue of its access to ConRail service. The other category is the elimination of claims that would have been reached in a reorganization to the extent that these exceed the value of the related properties. Illustrative and most important is ConRail's assumption of equipment obligations. Section 303(b)(3)(A)(ii) provides in part that conveyance of rolling stock (defined to include locomotives, freight and passenger cars, and work equipment) may be effected only if—

> (I) the Corporation [or other persons] to whom such conveyance is made assumes all of the obligations under any applicable conditional sale agreement, equipment trust agreement, or lease with respect to such rolling stock (including any obligations which accrued prior to the date on which such properties are conveyed). . . .

The Government parties contend that the transferors received OB to the extent that the liquidation value of rolling stock transferred under the Act was less than the assumed obligations upon it that would have been reached in the respective bankruptcy proceedings.

As compared with these two items, the Statement lists, without limitation, five other items which the Government parties would claim as VOB if any part of the rail properties of a transferor were to be valued under a scenario providing for continued rail use in the absence of the Rail Act: (1) expedition of and exemptions from regulatory action; (2) avoidance of operating costs after April 1, 1976; (3) avoidance of executory contracts and inchoate obligations; (4) avoidance of labor protection costs; (5) and avoidance of loss on retained properties to the extent that the FSP provided more rail service than an alternative scenario would have done.[63] All these claims are hotly disputed by the transferors.

63. The Government parties recognize that some of these items might be taken as deductions in the alternative scenario itself; to that extent, of course, they should not be counted again as OB.

The briefs have also flushed out a legal point that had escaped our attention. Section 303(c)(1)(A)(i) directs us to decide whether the transfers or conveyances to ConRail "in exchange for the securities, certificates of value and the other benefits accruing to such railroad as a result of such exchange" are fair and equitable; § 303(c)(1)(A)(ii) directs us to decide whether the transfers or conveyances to profitable railroads, States or responsible persons "in exchange for compensation and other benefits accruing to such transferor as a result of such exchange" are fair and equitable.[64] On the other hand, § 306(c)(4) provides that determination of the base value of the CV's involves

> subtracting the value of other benefits provided under this Act, as determined by the special court. . . .

Most of the transferors contend that the omission of the "as a result of such exchange" language in § 306(c)(4) was simply permissible Congressional shorthand and does not indicate any intention that we should determine VOB on any more enlarged basis under § 306(c)(4) than under §§ 303(c)(1)(A)(i) and (ii). We do not understand that the Government parties seriously dispute this. We hold the meaning to be the same;[65] when Congress in § 306(c)(4) used the phrase "as determined by the special court," it referred to the determination we had been directed to make under §§ 303(c)(1)(A)(i) and (ii). The omission of the phrase "as a result of such exchange" will therefore not be considered significant.

There is less agreement over the effect of that qualifying phrase. However, it would be wasteful to review the somewhat

64. The "as a result" language was contained in § 303(c)(1)(A)(i) of the Act as enacted in 1974. The 1976 amendment added to both subsections: "(taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have occurred in the estate of each such railroad during the bankruptcy proceeding with respect to such railroad)."

65. The NH Trustee suggests that the language of § 303(c)(4) may be *more* restrictive because of its use of the words "provided under this Act." Brief at 5 n.7. We reject this suggestion.

abstruse arguments that have been presented on that issue until we know just what OB are claimed and allowed. And this, as almost all parties agree, will depend on both the theory of value and the specific hypothetical dispositions of rail property put forward by the transferors. We have therefore concluded that it would be unprofitable for us to endeavor further to clarify the subject of VOB at the present time.

IX. *Conclusion*

As we review this opinion, we must confess some disappointment at the rather meager results which the extensive briefs and arguments of able counsel and our intensive consideration of them have produced. However, our malaise goes deeper. Even on the chart we have drawn for the future course of these proceedings, a chart which the transferors will doubtless claim to have wrongly precluded many lines of pertinent proof, the parties and this court seem doomed to spend years in an enterprise as unsatisfying as it will be interminable. We are to endeavor to fix the values of these enormous properties by estimating what the transferors could have realized by engaging in one course of action—ceasing operation and selling all of the property as scrap—that was never seriously considered by anyone, or another—an endeavor by each of the transferors to find a buyer or buyers for parts or all of its lines and selling the rest for scrap—that was not explored because it had become evident early in 1973 that something like the Rail Act would be adopted. Although the estimation of scrap value would not be simple, the problems inherent in determining value for railroad use are staggering. Even if we should take the easiest assumption—one which the transferors may not adopt and which the Government parties will doubtless contest—namely, that the transferors would have acted as a group and dealt with the western and southern railroads as a group, and then determined what lines would have been purchased, we would next have to determine what the buyers

would have paid.[66] We can assume that the transferors would not have sold for less than scrap value and that the buyers would not have paid more than a capitalization of the losses they would have suffered from cessation of service by the sellers = the income (or deficit) from the properties bought. But where would the bargain have been struck? As said in the opening brief of the New Haven Trustee (p. 67), "it is impossible to refine the model to such a degree that a price, or formula for such a price, can be determined precisely, or even to predict the particular bargaining strategy each would adopt"; the Trustee believes the price most likely to be reached would fall in the band between the arithmetic and geometric[67] means of the original offers (p. 72). However this may be as to the entire universe of sales, there is no assurance that it would be true in the particular instance before us; common experience tells us that a negotiator will often adhere rather closely to his starting position if he feels confident of his superior bargaining power. Further guessing would be needed as to how the price should be allocated. To take just one example of the difficulties, a transferor whose line was not included in the hypothetical purchase might claim some share on the basis that the disappearance of its line enhanced the desirability of those that were continued: indeed, the transferors would very likely insist on some provision to deal with this contingency before joining the selling group.[68]

66. The Government may also be expected to argue that even a consortium of buyers would not have had the resources needed to rehabilitate the purchased properties.

67. The geometric mean is the square root of the product of the two starting prices.

68. *See Cross, The Economics of Bargaining* 42-90 (1968), for a discussion of other factors that would affect the outcome of the bargaining process.

Economists, as a rule, are not so sanguine as the New Haven Trustee about their ability to determine where the bargain will be struck between the parties' bargaining limits. *See, e.g., Ferguson, Microeconomic Theory* 281-82 (rev. ed. 1969); *Henderson & Quandt, Microeconomic Theory* 247 (2d ed. 1971); *Shows & Burton, Microeconomics* 475 (1972); *Cohen & Cyert, Theory of the Firm: Resource Allocation in a Market Economy* 278-81 (2d ed. 1975).

We do not believe that Congress expected that this court would have to engage in such a prodigious and time-consuming effort in conjecture. As indicated earlier in this opinion, we fear that when Congress adopted the Rail Act it had a false security with respect to the relative ease of our determining the values here at issue, supposing that this would follow the model used in the New Haven inclusion in Penn Central. Indeed the FSP so declares. Vol. I, at 124.[69] Even that valuation had taken three and a half years for a much smaller property, but it was doubtless thought that more manpower could be deployed and that there would not be the same shuttling between the Interstate Commerce Commission and the courts. Little or no consideration seems to have been given by Congress to the complications arising from the fact that, whereas the hypothetical NH liquidation involved a single seller, the one here at issue would involve many. It is even clearer that Congress acted upon this expectation of a relatively speedy solution when it adopted the amended Act in 1976, with the FSP and its description of the MLP before it, *see* Vol. I, at 124-28, and with the need for taking account of possible sales for railroad use dismissed on the easy basis that "the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses," Vol. I, p. 125, an assumption which was unexplained and in our view, unsound, *see* pp. 31-32, *supra*.

Our discussion in Part IV should have made two things very clear. One is that we will not value these properties on the basis of or even "consider" such fantasies of "experts" as RCNLD, trended OCLD, social value, etc., that would provide a bonanza to investors beyond anything of which they could have justly dreamed in the dark days of 1973. The nation's need for rail

69. These statements are not contrary to our ruling that the Rail Act cannot properly be read as *prescribing* that method of valuation. We are here stating only what we think Congress expected, not what it prescribed or what the Fifth Amendment demands.

service affords no basis for the award as just compensation of "values" which these properties have not possessed for years and which their owners could never have realized except through condemnation by the Federal Government. The other is that we will not limit just compensation to provable market values if the transferors, through no fault of their own, cannot prove market value with sufficient nicety. We again remind the parties of the wisdom of Mr. Justice Black that "when market value has been too difficult to find, or when its application would result in manifest injustice to owner or public, courts have fashioned and applied other standards," *United States* v. *Commodities Trading Corp., supra,* 339 U.S. at 123. We have mentioned as one other standard that may be found worthy of consideration original cost subject to appropriate deductions—a figure which can be ascertained, with relative ease and without much guesswork, from records whose maintenance has long been required by law. We invite the parties to consider whether their interests might not be better served by endeavoring to reach agreement on a figure that can be so derived rather than by asking this court and ultimately the Supreme Court to seek a resolution, necessarily unsatisfactory to some and perhaps to all, among the conflicting opinions of experts as to what could have been obtained by way of sales, with the attendant lapse of years and the incurring of enormous expense. We do not mean to limit such consideration by the parties to original cost with appropriate deductions—perhaps there is some better way. But we would be remiss if we did not advise the parties and also the lawmakers of our fears as to the length and cost of these proceedings if they are carried to a conclusion under the charter that has been given us, even with the simplifying limitations we have here imposed. Nearly four years have elapsed since the Rail Act was adopted and a year and a half have gone by since the conveyances. Yet despite earnest and sincere efforts by all concerned, we are only at the start of the valuation problem.

The parties are directed to proceed in the manner directed in this opinion. If the Acting Liaison Committee believes a conference between it and the Court would be desirable, we shall be glad to meet with them.

APPENDIX F

Appendix F

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed October 31, 1977, James F. Davey, Clerk

Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT.

Order Postponing Effectiveness of Order of Denial of July 5, 1977

Upon consideration that—

a. on July 5, 1977, in its opinion On Motions for Reconsideration of Opinion of April 19, 1977, on Compensable Unconstitutional Erosion (CUE), this court postponed the effective date of its order of denial until November 1, 1977; and

b. on October 25, 1977, the Trustees of the Property of Penn Central Transportation Company, Debtor, and certain affiliated Penn Central Transferors filed a motion for reconsideration of the Special Court's decision of October 12, 1977, which has been joined by several other parties; and

c. on October 28, 1977, the Trustees of the Property of Penn Central Transportation Company, debtor, and certain affiliated Penn Central Transferors filed a motion to postpone the effectiveness of this court's order of denial of July 5, 1977; and the court has been informed that the Government Parties do not object to the granting of the requested postponement,

Appendix F

IT IS ORDERED that the court's opinion of July 5, 1977, is modified to postpone the effectiveness of the order of denial until such date as the court disposes of motions for reconsideration of the October 12, 1977, opinion.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

October 31, 1977

APPENDIX G

Appendix G

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed November 18, 1977, James F. Davey, Clerk

Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

On Motions for Reconsideration of Opinion of October 12, 1977

The Trustees of the Property of Penn Central Transportation Company and certain affiliated transferors (hereinafter the movants) having moved for reconsideration of this court's decision of October 12, 1977 (the decision), which motion has been joined by the Intervening Penn Central Lienholders; the Trustees of Erie-Lackawanna Railway Company and certain affiliated non-bankrupts; the Trustee of the Lehigh Valley Railroad Company; North Pennsylvania Railroad Company, Delaware and Bound Brook Railroad Company, Philadelphia, Germantown and Norristown Railroad Company, Plymouth Railroad Company (the NBIO's); the Peoria and Eastern Railway (P&E); and others, it is ordered as follows:

1. The movants' first ground for reconsideration is that this court should make clear that the holding on pp. 17-18 of the decision that the method prescribed in § 306(c)(5) for determining the value of ConRail securities would pass constitutional

muster in the sense that such securities might be used as part of the payment for the transferred properties, was not intended to preclude the transferors from contending that the particular method of valuing the ConRail securities was so unfair as to be unconstitutional. We agree; we will arrange for this to be taken up at a more appropriate time.

2. The movants' second ground is that this court "should make clear that no ruling has been made concerning the types of evidence relevant to show what buyers other than the Federal Government would have paid for the transferors' properties absent the Rail Act." (Motion p. 9) More specifically the movants ask us to say that our rejection of the reproduction cost and other types of evidence discussed at pp. 77-89 was confined to a hypothetical sale to the federal government, to which the reified property concept urged by some transferors should clearly be added, and would not preclude the offer of such evidence, notably real estate assemblage costs, if relevant to show "that, absent the Rail Act a particular corridor would have been sold to a private buyer who needed to acquire such a right-of-way and would otherwise have to assemble real estate parcels into a continuous corridor." (Motion, p. 8)

Our discussion was not intended to be as limited as the movants suggest. We had already rejected inclusion of the United States in the market (pp. 42-43) and the reified property concept (pp. 36-37) on other grounds. The principal purpose of our discussion on pp. 77-89 was to relieve the transferors of the expense of preparing and this court of the burden of hearing and passing upon studies of reproduction cost, etc., tendered on the basis that we might turn to such methods of valuation if efforts to establish market value proved unsuccessful. Although our discussion did not focus specifically on the possible relevance of such evidence to the price that would have been paid by profitable railroads or by public bodies other than the Federal Government, we think the

instances where such evidence would have even minimal relevance, if existing at all, would be exceedingly rare. It is hard for us to understand why profitable railroads would have paid more than "a capitalization of the losses they would have suffered from cessation of service by the sellers ± the income (or deficit) from the properties bought," which we considered to be the upper limit of the bargaining range (p. 104), simply because it would cost more to reproduce the property. It is equally hard for us to visualize public bodies taking into account such values as "assemblage costs," and the inclusion of any such items would acutely raise the question discussed on pp. 96-97 of the decision. Hence, while the movants may be literally correct in saying (Motion, p. 8) that we did not mean "to exclude all such forms of evidence in all circumstances" (save for the principle of *Foley Square*), our instructions to the masters, while taking account of the considerations now urged, will permit receipt of evidence on valuation theories generally rejected in pp. 77-89 of the decision only on a preliminary showing that particular prospective buyers would in fact have given weight to them — and perhaps only after submission of the question to the court. In sum, by agreeing with the movants to the exceedingly limited extent here indicated, we do not mean to allow quantities of evidence of reproduction cost, etc., to enter by the back door.

3. The movants ask us to reconsider our discussion (pp. 58-64) of decisions of the Court of Claims relating to the Government's use of patents. We find no reason to do so.

The additional point raised by the NBIO's does not persuade us to modify our holding on pp. 13-18 except as stated in item one above. We make the same ruling with respect to the P&E. If, as alleged in its statement of additional grounds for reconsideration, a 1972 study showed that major portions of its lines "could feasibly be sold or leased to other profitable rail lines", P&E should be able to establish a market value that will reflect this. We still

hold that CV's and ConRail securities, properly valued, may be used to pay part or all of this.

We have already taken action, in accordance with movant's request, to postpone the effectiveness of our CUE decision until the entry of this order.

Except as heretofore stated, the motions for reconsideration are denied.

HENRY J. FRIENDLY
Presiding Judge

JOHN MINOR WISDON
Judge

ROSZEL C. THOMSEN
Judge

November 18, 1977

APPENDIX H

Appendix H

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed November 24, 1981, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

Opinion With Respect to Valuation for Rail Use

WILLIAM C. LIEBLICH, Washington, D.C. and THOMAS R. RADOM, Southfield, Mich. (Thomas S. Warrick and Pierson, Semmes, Crolius & Finley, Washington, D.C.; David W. Berry, and Joseph S. Radom, P.C., Southfield, Mich., of Counsel), for Trustee of the Ann Arbor Railroad Company.

STANLEY WEISS, Newark, N.J. (Dean R. May and Carpenter, Bennett & Morrissey, Newark, N.J., of Counsel), for Central Jersey Industries, Inc.

John N. Malyska, Newark, N.J., for Delaware and Bound Brook Railroad Company.

HARRY G. SILLECK, JR., JOHN L. ALTIERI, JR., and HOWARD W. GOLDSTEIN, New York, N.Y. (Peter W. Asher, Thomas G. Gallatin, Jr., Jack P. Adler, Harold G. Levison, Susan M. Schmedes, Frances E. Edwards, Douglas M. Parker, Frank T. Laznovsky, Robert A. Jaffe, Karen M. Cullen, Robert A. Cantor, and Mudge, Rose, Guthrie & Alexander, New York, N.Y.,

of Counsel), for Trustees of the Erie Lackawanna Railway Company.

JOHN MICHAEL CLEAR, St. Louis, Mo. (Stuart R. Warren and Bryan, Cave, McPheeters, & McRoberts, St. Louis, Mo.; Harry G. Silleck, Jr., Peter W. Asher, John L. Altieri, Jr., and Mudge, Rose, Guthrie & Alexander, New York, N.Y.; David C. Toomey, Jared I. Roberts, Robert C. Unger, Jr., Lewis R. Olshin, and Duane, Morris & Heckscher, Philadelphia, Pa.; Howard H. Lewis, James A. Sox, and Obermayer, Rebmann, Maxwell & Hippel, Philadelphia, Pa.; John Vanderstar, S. William Livingston, Jr., Carolyn F. Corwin, Arvid E. Roach II, and Covington & Burling, Washington, D.C., of Counsel), for Joint Terminals Transferors.

DAVID C. TOOMEY, Philadelphia, Pa. (Jared I. Roberts, Richard C. Unger, Jr., Lewis R. Olshin, and Duane, Morris & Heckscher, Philadelphia, Pa., of Counsel), for Trustee of the Lehigh Valley Railroad Company.

Thomas E. Tyre, New York, N.Y., for North Pennsylvania Railroad Company.

CHARLES I. THOMPSON, JR., Philadelphia, Pa., for Philadelphia, Germantown & Norristown Railroad Company.

HOWARD H. LEWIS, Philadelphia, Pa. (James A. Sox, Richard W. Vitaris, Robert F. Stewart, Jr., and John F. Ehlinger, Jr., and Obermayer, Rebmann, Maxwell & Hippel, Philadelphia, Pa., of Counsel), for Reading Company and Certain Affilialted Transferors.

WILLIAM R. PERLIK, MICHAEL S. HELFER, ROGER M. WITTEN, DAVID R. JOHNSON, ERIC A. VON SALZEN, and STEPHEN C. ROGERS, Washington, D.C. (Peter F. Rousselot, Robert H. Kapp, Joe Chartoff, George W. Miller, Gail Starling Marshall, George W. Mayo, Jr., Walter A. Smith, Jr., V. Mark J. Policy, William J. Cassidy, Jr., Ronald E. Stauffer,

Cathy A. Simon, Wallace A. Christensen, Stephen A. Goldberg, David C. Kohler, Karen L. McClearycale, Ann Morgan Vickery, Kevin J. Wolff, George H. Mernick, III, Paul W. Nolan, Steven B. Rotman, R. Verne Bradford, and Hogan & Hartson, Washington, D.C.; Henry T. Rathbun, Arthur Z. Gardiner, Jr., A. Douglas Melamed, Richard W. Cass, David M. Becker, William J. Perlstein, Stephen P. Doyle, John B. McNeece, III, Maury J. Mechanick, Bruce E. Coolidge, Marie N. Doland, Lauren B. Homer, Sheila Bihary, Joan S. Powers, Judith Barry Wish, and Wilmer, Cutler & Pickering, Washington, D.C.; Cary W. Dickieson, Frazer C. Hilder, David H. Siehl, David L. Prestemon Barbara E. Sosnick, Larry C. Malski, Jonathan E. Pansius, and Mark H. Sidman, United States Railway Association, Washington, D.C., of Counsel), for United States Railway Association.

Alice Daniel, Asst. Atty. Gen., John H. Broadley, Thomas S. Martin, and Jane A. Restani, Department of Justice, Washington, D.C., for United States of America.

Appendix H

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Appendix H

PER CURIAM:

We here set forth such conclusions as we have been able to reach with respect to the value the transferors (Ts) which have not settled their cases could have obtained for properties that would have continued in rail use. We state the scope of this long opinion thus modestly because of several factors that could not have been anticipated when our *CMV Opinion,* 445 F.Supp. 994 (1977), and our initial pre-trial orders were issued.

During the course of the proceedings, although after the evidentiary hearings were concluded, Penn Central (PC), the largest T, representing some 80% of the case in terms of property value, settled with the Government Parties (GPs)—the United States and the United States Railway Association (USRA). This was quickly followed by settlements on the part of several small Ts—the Lehigh & Hudson, the New York & Long Branch, the Pennsylvania-Reading Seashore Lines, and the Dayton Union. After the case had been briefed and argued and this opinion had been partially drafted, another important T, Reading (R) and its subsidiaries, also settled. Shortly thereafter, the independent owners of rail property operated by R, the Philadelphia, Germantown & Norristown, the Delaware & Bound Brook, and the North Pennsylvania, reached settlements with the GPs. Then the Niagara Junction Railroad, jointly owned by PC, Lehigh Valley (LV), and Erie Lackawanna (EL); the Kalamazoo, Allegan & Grand Rapids Railroad, and independent line leased by PC; and the Norwich & Worcester agreed in principle to a settlement of each of their claims with the GPs. This left EL, LV, Central Railroad of New Jersey (CNJ), Ann Arbor (AA), and Lehigh & New England (L&NE) as the only Ts whose claims are still at issue.

When this opinion had been substantially completed, save only for minor textual revision, final checking, and typing, EL and

the GPs, on October 22, 1981, filed a motion for an order suspending litigation activities between them. The motion stated that on October 19 negotiators for the United States, USRA, and the El Trustees had reached an agreement for a settlement subject to necessary approvals of their principals. Government counsel explained, at a conference with the Presiding Judge of this Court, that the obtaining of all necessary Government approvals might take several weeks. Upon these being obtained, the EL Trustees and the GPs proposed to submit the settlement agreement to us for approval. An order to show cause why the order suspending litigation should not be entered was issued on October 22, 1981, Sp. Ct. Rep. N 37875; no objections having been filed, the order was entered. On November 17, 1981, the GPs and the EL Trustees petitioned for approval of the settlement, and this court has entered an order to show cause specifying the procedure for intervention and the filing of objections, and setting a hearing for January 25, 1982.

As pointed out in a memorandum accompanying the motion to suspend litigation, our hearing on the approval of the settlement must take account of Order No. 1094 of the District Court for the Northern District of Ohio in the EL reorganization proceedings. In this order, dated September 9, 1981, Judge Krupansky, the reorganization judge, authorized the EL Trustees to enter into a settlement agreement with the GPs subject to our approval and without the necessity of further proceedings in the reorganization court respecting the terms of the settlement. This authorization was conditioned on the Trustees' giving "reasonable notice to all parties customarily notified in these [reorganization] proceedings of any hearing before the special Court concerning approval of such settlement agreements and shall support any such party's

right to be heard by the Special Court concerning any such settlement agreement". In the event that any party to the reorganization proceeding filed a timely petition to intervene in this court and we did not permit it to intervene and be heard, the authority granted the Trustees by Order No. 1094 was made subject to further order of the reorganization court at which such party would be given an opportunity to be heard. Our order to show cause with respect to the settlement takes account of Judge Kurpansky's Order No. 1094.

We have concluded that, despite these developments, we should not defer the filing of this opinion until after the approval hearings on the EL settlement have been concluded. As will appear hereafter, we cannot and do not here arrive at the figure which, in our view, EL would have obtained in these proceedings; the greatest unknown and at present unknowable is the value of the passenger lines in Northern New Jersey which we conclude that the State would have purchased despite their negative earnings value. Release of the opinion in advance of the settlement approval hearing should assist the parties to the reorganization proceeding and ourselves in appraising the fairness of the settlement without, however, precluding its approval as an opinion setting total value might have done. We say "might" since even if we had arrived at a total figure higher then the value of the settlement (including the significant benefit to EL of receiving the proceeds now rather than on December 31, 1987, see Rail Act § 306(c)(1)), account would have had to be taken of the possibility of disagreement by the Supreme Court with some or even all of our conclusions that are favorable to EL. Moreover, we think justice requires that the railroads that have not settled should be advised of our conclusions as soon as we are ready to announce them, both because the scheduling of the nonrail use phase of the case is geared to such announcement, Sixth Pre-Trial Order, ¶7, Sp. Ct. Rep. at N

35967, and because the announcement may facilitate settlement by them. When EL and the GPs have deferred their settlement so long, we perceive no obligation on our part completely to rewrite the opinion at this late date so as to eliminate the lengthy discussion of EL's case, with the possibility of having to restore this if the settlement should be disapproved.

One major obstacle has prevented our accomplishing as much as we had hoped in this opinion. In a good many instances Ts have argued that rail use properties would have been sold at a price equal to or at a premium above their value for nonrail use. Analysis has made clear that the parties entertain widely different views as to what nonrail use value is and, for reasons developed in Part III of this opinion, the determination of that Issue must await the nonrail use phase of the case, although we do here rule on whether premiums would have been paid or deductions made.

While, as we recognized long ago, *CMV Opinion,* 445 F.Supp, at 1044, no amount of evidence, argument, deliberation and study can produce a single demonstrably right figure, we had hoped to be able to produce in this phase of the case definite figures of value for rail use. Although we have not been able fully to achieve this goal, we have been able to decide a large number of issues, to set forth the general method we intend to pursue in completing our work, and to focus the parties' attention on certain problems that must be dealt with in the ensuing phase of the case dealing with nonrail use value. Conceivably, this may cause the remaining parties and the GPs to do what we recommended over four years ago, *CMV Opinion,* 445 F.Supp. at 1045-46, and what finally was done in the cases of PC, R, and EL as well as those of smaller railroads, namely, to arrive at reasonable settlements.

We shall begin our opinion with two expository sections, Part I recounting the procedural history of the case since the *CMV Opinion* and Part II summarizing the positions of the parties.

Appendix H

Part III contains a legal analysis of certain problems, particularly as to what we may or may not properly now decide, that have surfaced during the presentation of this phase of the case. This is followed by six parts dealing with "cut-across" issues relating to claims for values based on earnings power, to wit, the claims of the GPs that the Ts' assertion of earning power should be rejected out of hand because of the allegedly hopeless conflict between them and the history that led to enactment of the Rail Act (Part IV); the nature and effect of bargaining (Part V); the GPs' claim that purchasers would have sharply reduced the Ts' estimates of future earnings because of inflation (Part VI); the method for translating estimated future earnings into earnings value (Part VII); the deductions that a purchase would have made because of the need to rehabilitate and maintain the properties (Part VIII); the deductions that a purchaser would have made to reflect the cost of labor protection conditions (Part IX); and the timing of projected sales and the conditions, if any, that the Interstate Commerce Commission (ICC) would have affixed (Part X). In Part XI we deal with a number of vexing issues concerning proposed acquisitions by public bodies. Part XII Is devoted to problems not theretofore considered relating to the sales for earnings value proposed by EL, LV, AA, and L&NE. Finally, in Part XIII, we deal with special contentions made by CNJ.

I. Procedural History

The *CMV Opinion*, 445 F.Supp. at 1009, set out a schedule designed to initiate a phase of the case intended to determine values the Ts could have obtained for their properties for continued rail use in the absence of the Rail Act. Each T claiming values from sales for rail use was required to exchange its proposal with all other Ts by January 9, 1978, so that they could meet among themselves to facilitate resolution of inconsistencies and deliver their resulting proffers to the GPs by March 9, 1978. The

GPs were given 30 days to indicate objections relating to inconsistencies and the Ts were to file their finally revised proffers with the court within 30 days after receiving the objections.

The First Pre-Trial Order, dated April 18, 1978, Sp. Ct. Rep. N 10078, further required that each T specify the principal rail use issues it believed had to be tried, along with a description of the evidence it intended to offer to demonstrate what it would have been able to realize for transferred properties in the absence of the Rail Act. This information and other reports from the parties provided the basis for a pre-trial conference on June 21-22, 1978, that led to the Second Pre-Trial Order, dated June 23, 1978, Sp. Ct. Rep. N 11796. It established a schedule for the submission of direct evidence by the Ts, and by the GPs on "affirmative defenses".[1] The latter issues included, among others, the cost of rehabilitating the properties proposed for transfer, the abilities of private purchasers and public agencies to finance the transfers, and the impact of labor protection obligations upon the values the Ts would have received for their properties. Most importantly, all direct evidence was ordered to be presented in writing.[2] The court rejected the proposals of various Ts that there be separate trials on separate issues because a single trial encompassing all rail use issues was believed conducive to more rapid progress. We also directed each T to submit its direct rail use case in such form as would permit us to make necessary adjustments where we found some but not all of a T's contentions persuasive. The significance of this order and the failure, perhaps in part inevitable, fully to comply with it, will become apparent in later parts of this opinion. Finally, as developed in Part III, preparation for trial of issues related to the values of the Ts' properties in nonrail use was deferred.

The Ts each submitted their direct evidence, accompanied by a memorandum summarizing the submission, in December 1978; the GPs' submission arrived as scheduled on January 31, 1979. The Third Pre-Trial Order, dated January 11, 1979, Sp. Ct. Rep. N 15287, provided that the parties should conduct discovery and

cross-examination by means of the deposition process, with discovery to be conducted by the exchange of information outside of the formal discovery process to the fullest extent practicable. One result of the dual requirement that all testimony be in writing and cross-examination be by deposition was to avoid what had been expected to be the need for a multitude of special masters in this phase of the case. This also permitted the parties to make their own agreements on how the discovery and cross-examination process should be handled and to conduct as many as a half-dozen cross-examinations simultaneously. The remainder of the order limited the number of depositions to which each witness could be subjected, provided that depositions may be offered for admission as testimony, and established procedures for the expeditious processing of objections.[3]

The Fourth Pre-Trial Order, dated May 16, 1979, Sp. Ct. Rep. N 17130, effected a more precise division between the rail and nonrail use phases of the case. We granted a motion of the GPs to defer consideration of evidence of nonrail use values or of appraisal methodologies for determining nonrail use values of any properties. However, evidence indicating that certain lines would have been kept in rail use for reasons other than their earnings power as well as evidence that purchasers of lines sold for rail use would have paid prices based in whole or in part with reference to nonrail use values was to be included in the rail use phase of the proceedings. All parties were directed to begin preparation of their nonrail use evidence at this time, although our consideration of that evidence was to be delayed until after this decision.

The Fourth Pre-Trial Order also directed the GPs to file their remaining evidence on rail use issues by November 1, 1979. This demand was less than successful; on October 23, 1979, the GPs filed a motion for a 90-day extension of time, Sp. Ct. Rep. N 18191, which was opposed by the Ts. The court could discern no adequate basis for the GPs' waiting until October 23 to call the problem to the court's attention, and also considered there was no

justification for the requested delay. Yet the public interest in fully developing the facts in this litigation required granting the motion of the GPs.

The Fifth Pre-Trial Order, dated March 27, 1980, Sp. Ct. Rep. N 19675, scheduled rebuttal evidence and started the briefing schedule. The Ts were givens until October 10, 1980, to file any additional rail use evidence by way of rebuttal. The GPs were ordered to file their schedule of depositions with respect to the Ts' rebuttal evidence by November 10, 1980. On October 24, 1980, the GPs moved to strike a substantial portion of the Ts' rebuttal evidence as not constituting proper rebuttal, Sp. Ct. Rep. N 22028. This motion was granted in part; we struck witnesses' repetition of initial testimony and other evidence that could and should have been presented years before, Sp. Ct. Rep. N 22621.

In the interest of expedition we ordered two simultaneous exchanges of briefs rather than sequential filings. The initial briefs were prepared on the basis of the Ts' and GPs' direct rail use cases, thus avoiding the delay that would have resulted from awaiting completion of the taking or rebuttal evidence. On May 8, 1980, in a separate order, Sp. Ct. Rep. N 20410, we denied the Ts' request that the initial briefs be accompanied by separate proposed findings of fact and conclusions of law to which opposing parties must respond. Initial briefs were scheduled to be due by December 2, 1980. Both sides were ordered to include in their briefs discussion of evidence developed by the opposing parties in their direct cases. Given the many statements of position and extensive testimony, each party was sufficiently aware of its opponents' cases to permit effective coverage in the initial brief subject to only minor supplementation later. The parties were also directed to include in their briefs the extent to which any claims of value to one T depended upon particular outcomes for other Ts.

The proceedings in this case were briefly interrupted when PC and its affiliated Ts, including the New York & Long Branch, 50 percent of which was owned by CNJ, and GPs entered into a

settlement agreement on November 16, 1980.[4] The net liquidation value of all rail properties transferred and conveyed by PC and its affiliated Ts was stipulated to be $1.46 billion. The parties further stipulated the value of other benefits and compensable unconstitutional erosion (CUE), see *CUE Opinion*, 439 F.Supp. 1351, 1355 (1977), applicable to PC and its affiliated Ts to be zero. Each group of settling parties released essentially all its claims arising under the Rail Act against the other. The agreement provided that the Conrail securities, stipulated to have been without fair market value, to be received by the PC and its affiliated Ts were to be assigned to USRA. PC and its affiliated Ts thus received Certificates of Value with April 1, 1976, principal amounts equal to the stipulated net liquidation value, which were to be redeemed immediately. One frivolous objection was filed in response to the court's November 17, 1980, order to show cause why the agreement should not be approved; after hearing, the objection was promptly overruled, and the settlement was approved on December 5, 1980, Sp. Ct. Rep. N 23314.[5]

This settlement, and the consequent disappearance of PC as a litigant which had taken the lead role for the Ts, complicated the task of the parties in preparing their opening briefs. In our separate December 5, 1980, order, Sp. Ct. Rep. N 23420, we therefore extended the date for filing initial briefs until January 12, 1981, and fixed April 20, 1981, as the date for reply briefs. The GPs' opening brief included 9 volumes of argument totaling almost 5,000 pages, 49 maps, and a 32 volume supplemental appendix. The bankrupt Ts still in the case submitted 12 volumes of briefs accompanied by 52 volumes of appendices, in addition to various other submissions.

Upon motion of the Ts, our March 24, 1981, order extended the due date for reply briefs until May 5, 1981. This time the GPs limited themselves to only 3 volumes and each T submitted only one, in addition to some additional volumes of appendices.

Oral argument was set for June 8-10, 1981. We heard for a day each from the Ts and GPs, with the former presenting rebuttal argument on June 10, followed by a few brief comments from the GPs. Prior to the argument, we had indicated to the parties a number of issues upon which they should comment at argument. In addition, the court in constructing this opinion has had the benefit of written clarifications and elaborations of the parties' arguments and positions which it has requested, in each case affording opposing parties an opportunity to respond.

On August 5, 1981, when considerable progress on the writing of this opinion had been made, the court received a petition of the GPs and the Reading Company, which had succeeded to the interest of the reorganization trustees of R, for approval of a settlement, Sp. Ct. Rep. N 36420. The agreement, which followed the general format of the PC settlement so far as practicable, settled the claims of R and five other companies for which it was (or expected soon to be) in a position to speak. The settlement for R and those five companies was for a base value of $87,497,489. With respect to several other lines which had not become bankrupts and in which R did not own a majority of the stock, the so-called NBIO's (non-bankrupt independent operators), the settlement contained a table of "Statutory Values", aggregating $33,475,095. These were sums at which the GPs were prepared to settle with each of these Ts. The Reading Company agreed to indemnify the GPs, subject to certain conditions, against any recovery by an NBIO in excess of its stipulated statutory value.

A hearing with respect to approval of the settlement was had on September 2, 1981. Objection was made by North Pennsylvania Railroad Company (North Penn), the largest of the NBIO's, for which the settlement established a statutory value of $21,593,547. North Penn did not attack the reasonableness of the $120,973,484 fixed as the base value for the entire Reading System but sought an evidentiary hearing to determine a "fair and proper allocation" of that sum to North Penn. Concluding

that North Penn had no right to such a hearing since it was left free to prosecute its own claim against the GPs, we entered orders approving the settlement and making certain provisions with respect to North Penn's prosecution of its claim, Sp. Ct. Rep. N 36847. Later North Penn decided to join the other NBIO's in entering into settlement agreements similar to R's at the "Statutory Values" set forth in the R agreement. No objection was made to these settlements.[6]

II. Position of the Parties

Given the dependence of each T's prospects upon what would have become of other Ts in the absence of the Rail Act, as well as the substantial overlap of issues across the claims of various Ts, it is useful to present at the outset a summary of the major contentions of the parties. In this portion of the opinion we make no attempt at completeness and express no judgment on the merits.

A. *Joint Terminals*

Four Ts (PC, EL, R, and LV) developed a proposal, not envisioned in our earlier consideration of the case, that freight properties within what are described as the Philadelphia and Northern New Jersey/New York terminal areas would have been purchased and consolidated by public bodies in the absence of the Rail Act.[7] Public bodies allegedly would have been motivated by the necessity of keeping the freight terminals in operation and the desirability of rationalizing the freight transportation system through elimination of duplicative and obsolete facilities and coordination to reduce the facilities necessary to perform terminal services, and to enhance integration of freight operations with commuter and passenger services.

These Joint Terminals (JTs) would have handled the switching, origination, and termination of all freight traffic within the area, interchanged cars delivered by main line trains, and provided service within the terminal areas, including service to and

from the New York/New Jersey and Philadelphia ports. The Northern New Jersey/New York terminal (NJ/NYTerm) properties were located in New Jersey, and concentrated along the Hudson River and New York Harbor, but extended north as far as commuter service or the New York state line, west to the Pennsylvania state line, and south to the Raritan River, and also included lines going beyond that to Trenton, West Trenton, and Bay Head, New Jersey. The Philadelphia terminal (Philaterm) included PC's and R's freight properties in the Philadelphia area up to the Delaware and New Jersey state lines and extended west in Pennsylvania as far as the limits of the electrified commuter network. Both terminals had some operating responsibility beyond these boundaries.

Under this scenario, the Joint Terminals Ts (JTTs) thought that public bodies would have purchased terminal freight properties for salvage value, with terminal operating costs to be recouped through switching charges covering the costs (other than capital costs) of services actually performed. Those JTTs with commuter lines argue in their individual cases that public bodies, not necessarily the same ones as those purchasing the JTs properties, would have acquired commuter and intercity passenger lines in the area at premiums in excess of nonrail use value. Both the GPs and the JTTs conducted JTs studies to determine how high the switching charges would have had to be to operate the terminals on a break-even basis. The requisite switching charges calculated by the GPs are on the order of twice those presented by the JTTs.

B. *Penn Central*

Although PC is no longer in the case, it is still necessary to understand its proffers since the probable dispositions and earnings values of other Ts' lines are to some extent dependent upon what would have become of parts of PC. PC contended that its high-density freight lines that connected major metropolitan

areas and provided interchanges with Western and Southern railroads would have been acquired by profitable railroads. Eight Intercity Freight Lines (IFLs) were to comprise this network: four major east-west routes—Chicago to New York (via Cleveland and Buffalo), Chicago to Pittsburgh, St. Louis to Cleveland, and St. Louis to Pittsburgh and Harrisburg with an extension to Perryville, Maryland, where it would join the "spine" of the Northeast Corridor[8]—and four shorter routes—Chicago to Detroit, Chicago to Cincinnati, Detroit to Cincinnati, and Youngstown to Ashtabula.[9] Individual Western and Southern railroads were identified as the most likely acquirers, each motivated by the fear of losing traffic if the IFLs were abandoned or purchased by competitors. Projections were also made for the possible acquisition of all the IFLs by a consortium of the Western and Southern railroads, as well as for purchase by the profitable Eastern railroads—Chessie and Norfolk & Western.

PC contended that its Northeast Corridor properties would have been acquired by public bodies for continued rail use absent the Rail Act. Amtrak was identified as a likely buyer for the spine, the main line of the Northeast Corridor running between Boston and Washington, D.C. State, regional, and local bodies would supposedly have acquired commuter lines connecting to the spine, and, if the negotiations already begun with Amtrak did not come to fruition, portions of the spine as well. One aspect of PC's valuation case was that an acquisition agreement for the spine would have included free trackage rights for PC's freight traffic. Other Ts were affected by the destiny of the Northeast Corridor since some proferred scenarios involved freight traffic originating, terminating, or moving over some of these lines.

Extensive evidence was taken in support of and in opposition to PC's claims. The issues are discussed at length in the GP's opening brief, which was in an advanced stage of preparation at the time of the PC settlement, but the remaining Ts by and large have not addressed these questions.

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C. *Erie Lackawanna*

In 1973, the EL system included 2,627 miles of track (exclusive of trackage rights) between Chicago and the NJ/NYTerm. Its principal line connecting the two points ran 970 miles; the system also included three feeder lines: from Marion, Ohio, to Dayton and Cincinnati; from Leavittsburg, Ohio, to Cleveland; and from Cuba and Hornell, New York, to Buffalo and Suspension Bridge, New York. Freight operations were conducted over the entire system, and commuter passenger traffic over 165 miles in Northern New Jersey. Two thousand ninety-five miles of EL's system were conveyed under the Rail Act.

EL's major contention is that a substantial portion of its freight lines would have been sold to a profitable railroad for continued rail use. EL argued that the road's chief problem was a lack of cash, which purchase by a profitable carrier could remedy. Western railroads — Santa Fe, Burlington Northern, Missouri Pacific, Southern Pacific, and Union Pacific — needed to preserve their connections to the East and thus were principal candidates. EL claims that an acquisition package suiting a Western acquirer's needs would have included the EL main freight lines between Chicago and Jersey City, as well as feeder lines to Cleveland and Buffalo and heavy density branch lines — 1,741 miles in all, of which 1,455 were conveyed pursuant to the Rail Act. EL labelled this package the EL Western acquisition. EL contends, however, that the potential acquirers would have been more likely to purchase a combination of EL and LV lines. This second package, the EL-LV Western acquisition, would have included the LV main line between the NJ/NYTerm and its connection with EL's main line near Waverly, New York, in place of EL's line between NJ/NYTerm and Binghamton, New York, (via Scranton, Pennsylvania) — 1,538 miles of the EL system in all, of which 1,252 were conveyed. EL's development of the EL-LV combination assumed that both EL and LV freight lines in New Jersey would have been part of the NJ/NYTerm, although they

also claimed that the earnings value of this combination would have been enhanced by inclusion of their individual New Jersey freight lines (other than those proposed for abandonment by EL) had the JTs not come into existence.

EL argues that Chessie and Norfolk & Western, concerned by an invasion of the East by Western railroads, also would have had an interest in purchasing its east-west lines. The EL Chessie acquisition package includes the same EL properties as the EL Western acquisition except for the EL lines west of Sterling, Ohio, the junction between EL's and Chessie's main line to Chicago — a total of 1,382 miles of EL track, of which 1,315 were conveyed. A fourth package featured an EL-LV Chessie acquisition, with a configuration similar to the EL Chessie acquisition — 1,145 miles of EL's lines, of which 1,078 were conveyed. Similar configurations for acquisitions by Norfolk & Western were proffered, although not specifically developed in EL's financial submissions. The Norfolk & Western packages would have included EL's lines east of Huntington, Indiana, the junction with Norfolk & Western's system.

EL's analysis shows the following earnings values for these lines:

Acquisition	*Earnings Value (in $1000's)*
Western (EL)	$225,908
Chessie (EL)	$244,985
Western (EL-LV)/JT	$278,077*
Chessie (EL-LV)/JT	$251,561*
Western (EL-LV)	$294,660*
Chessie (EL-LV)	$293,693*

* Indicates earnings values for the EL-LV combination, not EL alone. The two last figures adjust the earnings values of the Western and Chessie EL-LV acquisitions to reflect inclusion of EL and LV's JT freight lines in the acquired properties.

SOURCES: First four figures from 3 GP at H 12. The last two figures are calculated from the EL's July 10, 1981, Statement, Part II, Sp. Ct. Rep. N 36153 using EL's witness' valuation methodology.

EL argues, however, that opportunity costs, including traffic lost if EL and other bankrupts were shut to down, traffic lost if competitors made the acquisition, reductions in car hire deficits, and other factors, see 1 ELF at 108-09, and New York's willingness because of the importance of EL's line into and through New York State to make $100 million available to a private acquirer to facilitate the purchase, would have induced an acquirer to pay more than earnings value. In particular, EL asserted that it would have received a higher price based on "net salvage value",[10] which it computed for its properties as follows:

Acquisition	*Salvage Value (in $1000's)*
Western (EL)	$370,653
Chessie (EL)	$333,540
Western (EL-LV)	$310,854*
Chessie (EL-LV)	$273,741*

* The figures for the EL-LV combinations do not include the salvage value of $43.4 million for EL's freight lines and of $34.9 million for LV's lines in the JT area and of $39.6 million for LV's non-terminal lines.

SOURCE: 3 GP at H 12.

EL also contends that New Jersey would have purchased EL commuter lines (in addition to public acquisition of its JT area freight lines) for continued rail use due to their central role in New Jersey's commuter rail system. EL claims that the acquisition price would have included 10 percent premium over net salvage value, reflecting a combination of $5.7 million for the difference between net and gross liquidation value and $4.9 million for "going concern value". The State supposedly would have been willing to pay these additional amounts based upon a fear that a condemnation award would be even higher and a desire to avoid the litigation costs of condemnation proceedings.

Appendix H

D. *Lehigh Valley*

The LV had operated a 430-mile main route between Buffalo/Niagara Falls and Oak Island Yard near Newark, and 425 miles of branch lines. Five hundred thirty-nine miles of these lines were conveyed pursuant to the Rail Act. In addition, LV leased 128 miles of the Lehigh & Susquehanna that paralleled LV's main line in Pennsylvania on the opposite side of the Lehigh River. These lines were also conveyed, and are included as part of LV's rail use proffers.

LV suggested three possible rail use packages in which its properties would have been purchased in the absence of the Rail Act. The first involves sale as part of the EL-LV combination. This would have included LV's conveyed lines in Pennsylvania that continue from NJ/NYTerm and connect with EL just outside of Waverly, New York, near Sayre, Pennsylvania, as well as its lines from Sayre northward through Ithaca to Ludlowville, New York, and its terminal properties in the Buffalo area—382 miles, plus 113 miles in the NJ/NYTerm area and the leased L&S lines in Pennsylvania. The earnings values of the EL-LV combination in the Western and Chessie acquisitions were included above in our discussion of EL's proffers. The net salvage values for LV's properties are claimed to be $39.6 million (the same lines are involved for either acquirer), in addition to $34.9 million for its lines that it claims would be included in NJ/NYTerm. At oral argument EL and LV agreed that an award for an EL-LV combination based on earnings value should be divided in accordance with estimated salvage values. Tr. at 67, 107.

In addition to the EL-LV acquisition, LV claims that another possible outcome would have been the acquisition of its rail use properties, totalling 641 miles including the Lehigh and Susquehanna and LV's New Jersey properties (thus assuming the absence of a JT purchase by public bodies), as a single package by a large railroad capable of carrying freight between LV's lines

and more southern and western gateways. This package would yield an earnings value of approximately $75 million in early 1974 and $95 million as of April 1, 1976.[11]

Finally, LV argues that if none of the possibilities for private acquisition had materialized, 609 miles of its track would have been acquired at "non-earnings appraisal value" for the most part by the states[12] where its lines were located. The salvage value claimed for the New Jersey lines is the $34.9 million noted above in connection with valuation of the EL-LV combination. The lines in Pennsylvania were suggested to have a salvage value of $20 million and the New York lines of nearly $3.5 million. This proffer does not include LV's Buffalo area properties that it contends would have been kept in rail use as part of a Buffalo terminal system. Although included in the EL-LV capitalized earnings studies, as public acquisitions they would be valued as "specialized properties", a determination that has been deferred to a later phase in the case. Second Pre-Trial Order ¶ 12, Sp. Ct. Rep. at N 11802.[13]

E. *Reading*

As in the case of PC, despite the settlement of claims of all components of the Reading System, it will be useful to summarize R's case because of its bearing on those of other Ts.

In 1973, R's lines covered 1160 miles, mostly in eastern Pennsylvania with some lines extending into Delaware and New Jersey. Its principal freight lines connected Reading, Pennsylvania, with Lurgan, Pennsylvania, (via Harrisburg), Reading with Allentown, Reading with Philadelphia, and Philadelphia and Allentown (the latter using trackage rights) with Bound Brook, New Jersey. R's passenger services were in the Philadelphia area. Eighty-eight percent of its lines were conveyed under the Rail Act.

R claimed that 347 miles of its freight properties, designated "class (a)", would have been sold to a private purchaser in the

absence of the Rail Act, at an earnings value of $200 million. Chessie was identified as the most likely purchaser; Norfolk & Western and the acquirer of PC's lines west of Harrisburg would also have been interested. "Class (b)" properties—265 miles of freight and passenger properties—it alleged would have been purchased by unspecified public bodies: $67 million for the freight properties (as part of the JTs submission) and $61 million for its passenger properties. Memorandum Accompanying Dec. 31, 1978 Evidentiary Submission at 10-11. The latter claim included a 50 percent premium over net salvage value, which was predicated upon estimates based upon examinations of past negotiated acquisitions between public and private bodies, the social importance of the property, and arguments that public bodies would pay to avoid condemnation risks and costs. Finally, although R concurred in the latter portion of LV's arguments which R claims indicate the likelihood that its remaining conveyed properties, labelled "class (c)", would have been purchased for rail use by public authorities or groups of shippers, it does not contend that the acquisitions would have been at prices in excess of nonrail use value.

F. *Central Railroad of New Jersey*

In 1973, the CNJ system included 825 miles of freight and passenger lines within New Jersey, 756 of which were conveyed under the Rail Act. CNJ contends that it would have sold all its New Jersey rail assets (including those not conveyed) to the State of New Jersey for $100 million in the absence of the Rail Act. The CNJ's case emphasizes its value as perceived by a prospective purchaser, the State of New Jersey, as opposed to calculations of hypothesized earnings or scrap value performed after the fact by external sources. Its $100 million estimate is based upon discussions it had with state officials that were terminated as a result of our decision in the *180-Day Appeals*, 384 F. Supp. 895 (1974), holding that the CNJ should be reorganized

under the Rail Act. The CNJ claims further support for this valuation based upon appraisals of its scrap value that ranged from $80 to $121 million.

G. *Ann Arbor*

The AA had operated approximately 290 miles of lines from Toledo, Ohio, just south of the Michigan border, through Ann Arbor to Frankfort, Michigan, where car ferries operated to two points in Wisconsin. Two segments of its lines were conveyed. AA claims that the Ann Arbor-Toledo segment, approximately 54 miles, would have been purchased by the State of Michigan for $9.7 million based on the line's earning value. With respect to the conveyed segment running 131.2 miles between Durand and Cadillac, Michigan, AA does not claim more than its value for nonrail use.

H. *Lehigh & New England*

In 1973, the L&NE consisted of two segments of line in Pennsylvania: the first, a 22-mile line from a connection with R and LV at Bethlehem to Uhler, Pennsylvania, interchanging with EL at Bath; the second, a 5-mile line connecting with R at Tamaqua, Pennsylvania. L&NE had been a subsidiary of CNJ and, while not abandoned when CNJ withdrew from most of its operations in Pennsylvania, no longer connected physically with any CNJ line.

L&NE contends that all its property would have been acquired for continued rail use based upon its earnings value to a solvent carrier acquiring the above-mentioned connecting lines. The earnings value of the Bethlehem segment was estimated to range from $1.05 to $3.2 million, and of the Tamaqua segment from $1.2 to $2.45 million, depending on the acquirer.

I. *Government Parties*

The GPs advance a broad general denial of the Ts' claims. Their basic position is that, whether or not particular segments

would have continued in rail use, the Ts would have realized no more than nonrail use values for their assets. Earnings values are claimed to be either negative or insufficient to justify offers in excess of scrap value, and public bodies would not have been compelled to offer premiums to acquire any properties. Moreover, the GPs proffer a "Master Liquidation Plan" wherein all the properties of the Ts would have been sold for scrap in a short period of time, with resulting glut depressing the values of their properties. This so-called "benchmark" value for all Ts including PC was originally stated to be $630 million. At oral argument the GPs indicated that this would be revised upward to approximately $1.26 billion and that roughly 20 percent of this, equivalent to approximately $252 million, would provide "some notion" of the then nonsettling Ts' share. Tr. at 563. During oral argument, the GPs continued to emphasize their claim that the Ts still had not discharged their burden of showing nonspeculative solutions to their predicament in the absence of the Rail Act that would have yielded values better than offered by the Master Liquidation Plan. Since the GPs' various contentions will be discussed at length in the course of our opinion, there is no need to detail them further here.[14]

III. Introductory Analysis

The *CMV Opinion* established that the Ts are entitled to compensation for the properties conveyed by them under the USRA's Final System Plan (FSP) for whatever they could have realized for them in the absence of the Rail Act.[15] Determination of that amount is the issue we must ultimately decide in this case. In this phase of the proceeding the issue is the more limited one stated in paragraphs (1), (2), and (3) of the Second Pre-trial Order, to wit, "the values that would have been received for disposition of . . . [the Ts'] properties for continued rail use in the absence of the Real Act".

In so phrasing the issue for this phase of the case, the court had in mind a model, developed in considerable part from earlier proceedings, somewhat as follows:

> (1) The Ts would endeavor to prove that certain freight lines would have continued in rail use and would have had a realizable positive earnings value exceeding "scrap value" however "scrap value" might ultimately be determined.
>
> (2) The Ts would endeavor to prove that other lines, primarily passenger lines, although without a positive and even with a decidedly negative earnings value, would have continued in rail use as a result of purchase by public bodies and that these purchases would have been made at more than scrap value.
>
> (3) The GPs would contest the Ts' assertions as to the amount of mileage that would have remained in rail use.
>
> (4) In other instances and, as a secondary position in the cases described in (3), the GPs would contest the Ts' ability to have realized more than scrap value.
>
> (5) In cases where the court sustained the GPs' arguments described in (3) or (4), it would reserve the determination of scrap value to the second phase of the proceeding, which would also include the valuation of properties that the Ts conceded would not have continued in rail use.

The proceeding did not develop that way. One complicating factor was the introduction of the concept of the JTs, with public bodies assumed to have purchased the predominantly freight lines at "net salvage value" and the predominantly passenger lines within the JTs at a premium above this. Another was the proposal of several Ts that lines would be sold for continued rail use at "net salvage value". This is a concept the components of which

have not yet been fully explored and as to which different Ts may hold different views. Clearly, however, there is a wide gap between the Ts' concept of "net salvage value" and the GPs' concept of scrap value as embodied in the Master Liquidation Plan.[16]

As a result of these factors and perhaps others, the vast record and the exhaustive briefs contain little discussion of which of the proffered lines would have been continued in rail use even if a T's estimate of earnings value were not realized.[17] In order to be sure that the court was not misapprehending the GPs' apparent unwillingness to challenge the Ts' proffers on the ground that lines without substantial earnings value would not have continued in rail use, the court, on May 26, 1981, addressed a letter to the Chairman of the GPs' and the Ts' Steering Committees, Sp. Ct. Rep. N 36201. After noting that its reading of the briefs indicated that "the debate appears to be not so much over what lines would be continued in rail use but as to what the transferors would have obtained for them", the letter said that the court would be assisted by the GPs stating prior to the oral argument "which, if any, of the proffered lines the Government Parties contend would not have been continued in rail use regardless of sales price." The GPs' answer of June 3, 1981, Sp. Ct. Rep. N 35829, essentially accepting the court's characterization of what the debate had been, declined to furnish such a list. They stated that they "cannot and do not contend that any particular proffered line (indeed, any conveyed line) would certainly *not* have been continued in rail use regardless of sales price." The letter went on to say that this was not a concession "that the proffered lines would have been likely to continue in rail use in the absence of the Rail Act". It proceeded to argue that the GPs' evidence showed that "even the most valuable of the transferors' lines would have had negative or very low earnings values"; that accordingly "sales to private purchasers may well have been impossible for virtually all of the transferors' properties"; that, in contrast, "sales of some lines to public bodies could not be entirely

ruled out"; but that this possibility did not matter because public bodies would not pay more than the Ts' best private marketplace alternative, to wit, sale at scrap value.

In the absence of any adversarial position by the GPs with respect to continued rail use of any particular line, the court would be justified in considering that all proffered lines would have been continued in rail use except in those instances where the development of a T's own case demonstrated that if a particular acquisition were posited, portions of its railroad would have been abandoned.[18] This course would involve no procedural unfairness to the GPs;[19] the court's May 26 letter gave them an opportunity to argue which proffered lines would not have continued in rail use at any price and they chose not to make the gambit since in their view of the law it made no difference.[20]

Despite this, court is not inclined to abandon all inquiry into whether a particular line would have continued in rail use. The GPs did offer extensive evidence that public bodies would not have acquired proffered properties at any price, not because these were insufficiently important from a transportation standpoint but because the public bodies lacked legal power or financial ability to make the acquisition. We shall never be in a better position to pass on such arguments than we now are. Moreover, despite the GPs' unwillingness to engage in debate over whether lines would or would not have continued in rail use, we cannot ignore the Ts' argument that in weighing the likelihood or unlikelihood of their proposed dispositions, the court must consider that the discontinuance of essential rail service was the most unlikely outcome of all, with the consequence that in the absence of the Rail Act some basically nonfederal solution to the problems of rail service in the Northeast would have been found.

The foregoing and other developments have caused the court to be increasingly concerned with what it may properly decide in this opinion. This concern led us to begin the final day of the argument by addressing a series of questions on this subject to counsel for both sides. Tr. at 408-16. Our questioning made

clear that the parties were using terms sounding like scrap value in many different senses. We shall start at the bottom, with the GPs' Master Liquidation Plan, which would price all the Ts' properties on the theory that all properties of all Ts, including those that would have continued in rail use, and even some of those so continued because of high earnings value if such there were, would have been sold for scrap at substantially the same time. Another model, characterized by CNJ as "the residual scrap model", CNJRB at 30, "would price the property remaining in rail use by looking at a market affected by the simultaneous scrapping of all properties that would be withdrawn from rail use".[21] A third is what CNJ calls the "stand-alone" model, wherein the scrap value of any T's property would be computed without regard to the fate of the property of other Ts. Presumably this could encompass pricing either on the basis of a scrap sale of all properties or of only those that would in fact have been withdrawn from rail use. Highest on the scale is the net salvage value theory, already discussed, see note 16, *supra*, and accompanying text, which deducts only some of the costs of sale.

One point that is quite clear to us and, indeed, seems to be agreed upon by all the parties except CNJ is that at this stage of the proceeding we cannot properly decide among these theories or endeavor to apply the chosen one or ones. In ¶ 1 of the Fourth Pre-Trial Order, filed May 16, 1979, we granted the motion of the GPs "to the extent it seeks to defer the consideration of evidence with respect to determining non-rail use values of any properties or appraisal methodologies for determining non-rail use values of any properties", Sp. Ct. Rep. at N 17130-31. Properly relying on this, the GPs did not cross-examine or rebut statements by the Ts' witnesses relating to the Ts' net salvage value, appraisal value, etc. On the other hand, in the same paragraph of the Fourth Pre-Trial Order we directed that "evidence that purchasers of lines sold for continued rail use would have paid prices established in whole or in part with reference to various different types of non-rail use values shall be presented during the rail use phase of these

proceedings". Much such evidence was presented, briefed, and argued.[22] We believe that judicial economy would be promoted by deciding, at this stage of the proceeding, which properties would have been acquired at prices related to their nonrail use value and whether or not the acquirer would have paid premiums above or negotiated deductions from scrap value. For simplicity we shall sometimes refer to the values that we will determine in the second phase of the proceeding simply as X.[23] We shall expect the parties to give us maximum assistance in expert testimony, briefs and arguments on what now seems the most important "cut-across" issue in the nonrail use phase, namely, what properties should be considered in determining "glut" for a particular T. See Sixth Pre-Trial Order ¶7, Sp. Ct. Rep. at N 35968. We recognize that this solution does not provide as neat a distinction between the first and second phases of this proceeding as we had anticipated, but it seems dictated by the manner in which the case has unfolded.

IV. General Background Considerations

The court is confronted in this case with a task of almost insuperable difficulty. That is to determine what action would have been taken by interests of all kinds — the Ts, other railroads, state and local public bodies, the United States,[24] the ICC, labor, and shippers, in order to avoid a shutdown of the Ts (including PC) which would have entailed disaster for all.

As witness Charles Shannon[25] said, testifying for the PC, "any attempt to determine how the Northeast rail crisis might have been resolved if Congress had not enacted the Rail Act in 1973 is an essentially unrealistic enterprise", since "[t]here was never any realistic likelihood that the federal government would allow market forces to play a prominent role in the way in which rail service in the Northeast would be restructured". Shannon (S) (PC) (Dec. 31, 1978) at 2. The GPs come close to suggesting that this unreality should foreclose our consideration of the Ts'

proposals concerning what might have occurred. They repeatedly call our attention to the statement in *Olson* v. *United States*, 292 U.S. 246, 257 (1934), that

> [e]lements affecting value that depend upon events or occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable, should be excluded from consideration . . . .

However, that sentence must read along with the previous statements that in respect of each item of taken property the court must estimate market value,

> deemed to be the sum which, considering all the circumstances, could have been obtained for it; that is, the amount that in all probability would have been arrived at by fair negotiations between an owner willing to sell and a purchaser desiring to buy;

that

> [i]n making that estimate there should be taken into account all considerations that fairly might be brought forward and reasonably be given substantial weight in such bargaining;

and finally that

> [t]he determination is to be made in the light of all facts affecting the market value that are shown by the evidence taken in connection with those of such general notoriety as not to require proof.

Moreover, *Olson* involved a taking for a new use which the Court concluded no person other than the condemnor could accomplish and the statement relied upon by the GPs was addressed to that situation. While we agree with the GPs that the Ts bear the

burden of proof, this does not require them to show with something like mathematical certainty that hypothetical transactions would have occurred and hypothesized prices exactly realized. Their burden is simply to show by a preponderance of the evidence that transactions such as those proposed by them were more likely to have occurred than what the GPs argue was the Ts' next best alternative—abandonment and subsequent dismantlement. When they have satisfied that burden, the court must ultimately determine, as best it can, what the price would have been.[26]

The GPs begin their assault on the Ts' proposals, more particularly their freight line proposals, by painting a dismal picture of the conditions of the railroad industry, especially in the Northeast[27] as this appeared in 1973. A summary of this will suffice. For the facts the GPs relied heavily on a staff report of the Senate Committee on Commerce, dated December 1972, entitled The Penn Central and Other Railroads. They cite the report, 1 GP at A176-77, as concluding that railroads in this area suffered from

> [s]teadily declining freight volume, particularly in traditionally rail-carried bulk commodities such as coal, steel and forest products; outdated terminals that could not efficiently handle current volume, let alone any hoped-for increased volume; service problems, including an unbelievably high incidence of damage to shipments and inability to meet delivery schedules; steadily increasing competition from the more efficient motor and water carriers; deteriorated physical plants; outdated work rules and large job protection commitments; concerns of shippers, local governments and unions that would inevitably delay abandonments of unprofitable lines; and continued losses from fulfilling obligations to provide passenger service.

A significant source of the industry's problems was the relative decline in share of the gross national product represented by bulk

items as distinguished from services. Hence railroad shipments and revenues could fall even when the general economy was growing. Shifts in population away from the Northeast and the relocation of industrial plants into suburban industrial complexes and to points closer to the new population centers operated further to the disadvantage of the Northeastern railroads, many of which were left with substantial amounts of little used freight track into cities. For short and even for longer hauls of manufactured products, the railroads, because of lesser reliability and greater proneness to loss and damage, were unable to compete successfully with trucks. The GPs cite a gloomy report of the PC Trustees dated September 17, 1971, to the PC reorganization judge on the basic problems of the Northeastern carriers; on July 24, 1972, the LV Trustees rendered an even gloomier report to the same judge, claiming that, however bad PC's situation might be, PC was managing to maintain its strength at the expense of its smaller competitors. Declining earnings had led to deferral of maintenance, which led in turn to a further decline in service and revenue. The GPs' brief extensively recites statements by PC trustees as to the devastating effect of the number and expense of the freight terminals it was obligated to operate. On the other hand efforts in 1972 and early 1973 on the part of the R, LV, and CNJ Trustees to consolidate some operations in Northern New Jersey came to nothing, in part because representatives of the State were concerned over the impact of immediate large scale layoffs on organized labor. Antiquated work rules constituted a heavy burden, and the threat of labor protection payments clouded proposed shrinkage and mergers. Relatively little progress had been made in the way of abandonments. For many of the Ts, including EL and CNJ, as well as PC and R, passenger service created a further burden since state and local authorities were unwilling to subsidize more than avoidable costs.

The results of these developments were summarized in two tables in the GPs' opening brief, 1 GP at A 204, 206, comparing

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net railway operating income and freight operating ratios for five of the Ts for 1966 and 1972.

Net Railway Operating Income

	1966	1972
EL	$17 million	($7.7 million)*
R	$7.7 million	($12.1 million)
LV	($1.4 million)	($8.9 million)
AA	($288 thousand)	($1.1 million)
CNJ	($4.9 million)	($1.2 million)

* Numbers in parentheses indicate deficits.

Freight Operating Ratios

	1966	1972
EL	72.2%	83.3%
R	77.4%	89.5%
LV	84.2%	93.5%
AA	86.3%	93.1%
CNJ	89.1%	92.4%

The decline in net railway operating income was reflected in a decrease in cash flow and, with the accompaniment of inflation which made depreciation charges on equipment inadequate to provide for the cost of new equipment, required the railroads to incur even larger obligations, whether in the form of debt or leases, for the acquisition of new equipment. The average rate of return for railroads in the Eastern District, which includes profitable railroads such as Chessie and Norfolk & Western, from 1969 to 1973 was a mere 0.14 percent. Smith (S) (Jan. 30, 1980) Ex. 17 at 16. The GPs also call our attention to reports of trustees of the Ts to their respective reorganization courts in 1972 and 1973, many of which are cited in our *CUE Opinion,* 439 F.Supp. at 1359-62 (PC), 1381-82 (CNJ), 1383 (R), 1384 (LV), 1386-87 (EL), as to imminent cashlessness and the consequent need to shut down the railroad.

Citing from our *CMV Opinion,* 445 F.Supp. at 1088, the GPs conclude, 1 GP at A 211-12:

> It is difficult to envision against the picture painted in this Section—largely from published data from rail sources and from other contemporaneous public documents—that profitable railroads would have found it "in their 'own self interest' " to have paid large sums for the privilege of standing in the shoes of the transferors.
>
> It was clear in the early days of 1973 that none of the transferors could be reorganized on a conventional private income basis. They were faced with outworn physical facilities, heavy debt, negative earnings, inability to raise astronomical sums of essential capital, adverse economic trends beyond their control and operating problems which had been unsolved for decades.

They argue from this that "no rail use values inhered in the transferors' properties" and that they "are entitled to recover no more in these proceedings than the realizable nonrail use value of their properties".

The Ts do not deny that the 1973 picture for the Northeastern railroads was sombre. Their answer to the GPs is rather, to use Mr. Justice Holmes' phrase in his dissent in *Lochner* v. *New York*, 198 U.S. 45, 76 (1905), "General propositions do not decide concrete cases". As the case now stands, the only instances where we must determine the possibility of sale on a capitalized earnings basis are greatly pared-down versions of both EL and LV; the short Ann Arbor-Toledo segment of AA; and L&NE.

EL urges, 1 ELF at 27-34, ELRB at 14-22, that in 1973 it had one of the highest density ratings in the nation and the longest average haul of any carrier in the East; that its lines were in relatively good condition; that it had been steadily increasing its share of the eastern market, was well managed, and enjoyed excellent relations with shippers and labor. EL had rebounded from the adverse effect of the PC merger and produced freight net railway operating income of $11 million in 1971. It entered bankruptcy only in 1972, in consequence of the devastation

wrought to it and many of its shippers by Hurricane Agnes. In an order entered on April 3, 1974, pursuant to § 207(b) of the Rail Act, the judge in charge of EL's reorganization found that EL was reorganizable on an income basis pursuant to § 77 of the Bankruptcy Act. He relied upon a statement of position by the EL trustees "supported by comprehensive evidence, financial projections and economic feasibility studies by the highly respected Salomon Bros., banking and financial consultants, and Wyer, Dick & Co., railroad consultants". Plans for EL included the rebuilding and rehabilitation of its yard at Marion, Ohio, which was expected to pay for itself in two years and for which Salomon Brothers had already obtained financial commitments aggregating 80% of the cost, and also its yard at Croxton, New Jersey. EL contends that the only weakness in the plan it presented to the reorganization court was "a dangerously tight cash position in 1974 and 1975". 1 ELF at 33. This weakness became fatal as a result of the recession of 1974-75, accompanied by continued inflation. In an order dated January 18, 1975, the reorganization judge carefully reviewed these unexpected developments and concluded that EL no longer had the ability to continue reorganization on an income basis. However, EL contends, these adverse developments would not necessarily have precluded a solvent railroad from believing in 1973 and later years that EL, while perhaps unable to survive as an independent railroad, would have been attractive as part of a larger system if shorn of the burden of passenger deficits and unprofitable branch lines, and, as we shall see, EL submitted substantial evidence to that effect.

LV likewise contends that its admittedly bad condition prior to the Rail Act is not inconsistent with its claim that the proffered portion of its lines would had have earnings value as part of a larger system. It points out that from 1962 until PC's and its own bankruptcies in 1970 it was under the control of the Pennsylvania Railroad and, after the 1968 Pennsylvania-New York Central merger, of PC, both of which were competitors; that, as predicted by the hearing examiner on the Pennsylvania-New

York Central merger, this caused substantial diversion from LV; and that its Trustees had had significant success in rebuilding its traffic base. Beyond this many of LV's problems were attributable to its relatively short mileage, its longest possible haul being 443 miles between Jersey City, New Jersey, and Buffalo, New York, with the result that it received a small proportion of total revenues while bearing heavy terminal expense. This problem would have been alleviated by LV's inclusion in a larger system. Moreover, the portion of LV conveyed pursuant to the Rail Act, most of which was here proffered for continued rail use, was, in LV's words, LV at 16, "a very different system than the one the Trustees operated before conveyance". The FSP did not designate LV's main line west of Van Etten Jct., New York, or various branch lines in New York and Pennsylvania which "produced substantial costs and virtually no income", *id.*

AA claims, somewhat similarly, that the unprofitability of its 298-mile rail system as a whole casts little light on the earnings value of the 54.2-mile Ann Arbor-Toledo segment, which is all that is at issue here. Doubtless because of the special nature of its case, discussed in Part XIII of this opinion, CNJ makes no particularized reply to the general arguments of the GPs here under consideration.

The upshot of all this is that while the general arguments of the GPs being here considered suffice to create a considerable degree of scepticism over the Ts' assertions of earnings value, they do not relieve this court of the onerous task of detailed analysis of the Ts' proposals. If a T has presented a set of figures produced by competent witnesses which show significant capitalized earnings value, we cannot simply reject the proposition that the T might have obtained more than X from a solvent railroad, no matter how dismal the record of the past had been. We therefore turn from the background quite properly presented by the GPs to the specific claims advanced by the Ts.

Appendix H

V. Bargaining for Properties Having Earnings Value

Establishment by a T of a capitalized earnings value higher than X does not necessarily mean that the T would have been able to realize this in the marketplace. It might not have been able to realize that much; conceivably, if the "earnings" that were capitalized were simply those on the purchase line and other elements of value to the purchaser were not taken into account, it could have gotten more. As indicated in our *CMV Opinion*, 445 F.Supp. at 1044, the amount would have depended on a process of bargaining—a process which, the GPs insist, would have included not only the buyer and the seller of the particular property but many other railroads and public bodies on whose purchase of losing properties the earnings value of others would depend.

The parties produced two distinguished academics as witnesses on the subject of bargaining. The GPs called Donald Jacobs, Dean of the Graduate School of Management at Northwestern University; his direct testimony is contained in a volume entitled "The Nature and Consequences of Likely Bargaining among Interested Participants in the Alternative Scenario". PC called in rebuttal Thomas Schelling, Professor of Economics at Harvard University and Professor of Political Economy at its John F. Kennedy School of Government. Although his testimony was addressed primarily to the IFLs, many of his observations apply also to the properties here before us. In addition Shannon's testimony for EL and PC and Professor Alain Kornhauser's[28] testimony for PC entitled "Opportunity Costs for Potential Purchasers of the Intercity Freight Lines", contain a considerable amount of discussion about bargaining.

Professor Schelling did not disagree with some fundamental principles stated by Dean Jacobs, which we find it useful to set out. The most basic of these were:

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27. The fundamental principle of bargaining is that each party seeks through agreement to improve his position over that which it would occupy in the absence of agreement. A corollary is that parties assess the motivations and bargaining strengths of opposing parties with reference to those parties' alternatives. Parties will reach agreement if they believe that doing so will leave each of them at least as well off, and at least some of them better off, than they would have been in the absence of agreement.

* * *

29. In bargaining between a buyer and seller regarding a proposed sale of property, agreements are reached only if the property is at least as valuable to the buyer as it is to the seller. Only in such instances would a rational buyer be willing to pay enough to induce the seller to part with the property. If the seller is rational, it would not be willing to sell the property to any buyer for less than the value it could otherwise realize (by keeping the property or by selling it to another buyer). By the same token, a rational buyer would never pay more for a property than the value of that property to it (or more than it would have to pay to buy a substitute property of equivalent value to it). The maximum amount that the buyer would rationally pay for the property is called the buyer's "reservation price," and the minimum amount that the seller would rationally accept for the property is called the seller's "reservation price." Thus, if the buyer and the seller are rational, they will not agree on a sale of the property if the buyer's reservation price is less than the seller's reservation price.

Jacobs (S) (Nature and Consequences) (Nov. 1, 1979) at 11-13. Dean Jacobs called the excess of the buyer's reservation

price over the seller's reservation price "excess value". He testified also that account must be taken of the ability of third parties to postpone, prevent, or have disadvantageous conditions placed on the sale. Amounts required to be spent, whether by the buyer or the seller, to obtain the assent of such third parties would reduce the amount otherwise realizable by the seller.

It is worth noting at this point that ambiguities as serious as those to which we have already referred, see p. 28 & n.16, 30, *supra*, with respect to the parties' use of such terms as scrap value, salvage value, etc., which would constitute the seller's reservation price since the seller could obtain this amount without making the sale, are also present in the parties' references to earnings value. We find scattered through the record the following concepts of the earnings to be capitalized or otherwise taken into account; we have arranged these generally in ascending order:

> (1) The assumed future earnings of a line conceived as carrying essentially the same traffic as it did before the acquisition, increased or decreased only in accordance with estimates of general economic conditions.
>
> (2) The earnings reflected in (1) plus cost savings resulting from the acquisition.[29]
>
> (3) The earnings reflected in (1) and (2) plus earnings the buyer would have lost if the seller had ceased operation.[30]
>
> (4) The earnings reflected in (1) and (2) plus earnings the buyer would have lost if all the bankrupt carriers had ceased operation.[31]
>
> (5) The earnings reflected in some or all of the preceding plus earnings on traffic from or to points on the acquired road which the acquisition would permit the buyer to divert to its own line.[32]

(6) The earnings reflected in some or all of the preceding, plus earnings on traffic which in the absence of the acquisition would not have moved by rail at all.[33]

A capitalization of "earnings" that includes items at the upper end of this scale will produce a higher buyer's reservation price and consequent excess value than those at the lower, just as use of the Master Liquidation Plan's approach to scrap value rather than the Ts' various salvage value approaches will produce a lower seller's reservation price. Yet apparently neither Dean Jacobs nor Professor Schelling had been made aware of the ambiguities in what they conceived as the reservations prices of the two parties. Their conclusions, more particularly some of Dean Jacobs', must be read with this in mind. Thus, while one may readily accept that a buyer would not pay more than capitalized earnings value if that term included all the elements in the preceding scale, it is by no means clear that a buyer would not go beyond earnings value computed as outlined in (1) or (2).

Despite this we are inclined generally to accept Dean Jacobs' conclusion (although not all his reasons for it) that the seller would realize a relatively small share of "excess value" if there is only one potential buyer. The only leverage possessed by such a seller would be the threat to close down operations. We do not minimize this. Table B to Shannon's EL statement showed, for example, that assuming a 70 percent loss to Santa Fe of the 1973 traffic handled between Santa Fe and EL by a shutdown of EL alone and a 60 percent incremental cost ratio for handling the traffic, Santa Fe would have suffered an annual loss of $5,780,516 in pretax net income.[34] However, the 70 percent estimate appears to be on the high side, especially if one or more of PC's lines east of Chicago remained in operation.[35] Moreover, a buyer offering something more than X, particularly if this were X in one of its higher ranges, would find the seller's threat to refuse this and close down operations lacking in credibility. For one thing, if the offer were high enough in terms of X, the ICC would have

refused to permit abandonment (in the sense of dismantlement) pursuant to its established policy, see note 16, *supra*. Apart from this the trustees of few railroads of any size or the judges presiding over their reorganizations would have been perceived as having the moral stamina to force an actual shutdown, thereby foregoing any chance ever to realize more than had been offered[36] and becoming the subject of obloquy from public officials, shippers, and labor, when they had on the negotiating table an offer for something more than could be obtained by scrapping the road.

Our view that in the single-bidder situation the seller would not receive much over X must be qualified, however, by an important caveat, namely, that neither buyer nor seller would have known just what X would be. This would not have been so much for lack of information; several, perhaps all, of the reorganization courts had directed appraisals of the bankrupts to be made, and many of these were available in 1973. It was rather that no one knew how these appraisals would translate themselves into reality. What counts is what the buyer would have perceived the seller's likely receipts from dismantling or condemnation to be. Saying that in the absence of a competing bid the seller would not have received much of the excess value does not mean therefore that he might not have obtained considerably more than the prices contained in the Master Liquidation Plan.

Before considering what the division of the excess value would have been under competitive bidding, it is necessary to address the question whether such bidding would ever have existed. The GPs argue that it would not, since the interests of prospective bidders, especially if these were railroads, would have led them to join in bidding as a consortium. The motivation for this would have been not only to buy at a cheaper price but to avoid the disruption of traffic patterns that would have resulted, *e.g.*, if different Western roads had purchased various IFLs and EL. While any such purchases would have afforded opportunity for

diversion, the benefit of this might have been decreased or nullified by similar opportunities afforded by similar purchases by others, see note 32, *supra*.

We ourselves introduced the notion of purchase by a consortium when, in the *CMV Opinion*, we said, "we do not at all exclude such possibilities as joint action by the transferors in the Northeast Region or joint purchases by profitable railroads to the west and south which ordinarily might have been deemed objectionable under the antitrust laws", 445 F.Supp. at 1010. Although the prime thought behind our suggestion of a joint purchase was to overcome problems of lack of adequate financial resources,[37] we also had in mind the elimination of the opposition before the ICC and the endless battles over protective conditions and inclusion that have spun out the length of many railroad merger proceedings—sometimes to the point of killing the merger. Clearly § 5(11) of the Interstate Commerce Act, 49 U.S.C. § 11343, authorizes the Commission to confer antitrust immunity on carriers who have joined in purchasing another railroad, and the Supreme Court has approved its doing so, *Minneapolis & St. Louis Ry.* v. *United States*, 361 U.S. 173 (1959).[38]

Despite this we have the gravest doubt whether the Commission would have authorized a combination of all prospective bidders to purchase all the lines here proffered. No one has contended that the potential bidders would not have had resources adequate to effect the proposed purchases.[39] Hence approval of a consortium purchase could not be defended on the basis that it would not depress the market since otherwise there would have been none. Insofar as an objective of the consortium would have been to lower the price the Ts would have received, we do not see why it would not violate the antitrust laws just as does bid-rigging which results in the purchaser having to pay more, see *United States* v. *Koppers Co.*, 652 F.2d 290 (2 Cir. 1981); the antitrust laws are as concerned with sellers as with buyers. To be sure, § 5(11) empowers the Commission to grant exemption from the antitrust laws, and it can be argued that the Commission

would have been predisposed to do this since its primary interest lay in the continuation of rail service at the lowest cost. As against this the Commission would have realized that investment in railroad securities would hardly be promoted by its endorsing a policy that if a railroad has to be liquidated, prospective competing buyers can permissibly join forces to depress the purchase price. As to the alleged pro-competitive factors in a consortium acquisition through preserving established traffic patterns, we would think that, however forceful these considerations may have been in the case of a short-line "bridge carrier", such as the Toledo, Peoria & Western, which had observed and was pledged to continue to observe a policy of "strict neutrality between all connections", *Minneapolis & St. Louis Ry., supra*, 361 U.S. at 189, the situation would appear quite different if a half dozen or more carriers were buying the properties at issue here. Individual acquisition of various lines would open up possibilities of more aggressive competition, not simply by more energetic sales effort but because of the possibility of more efficient single line service; this is hardly to be disregarded because competition for shipments which had been and would continue to be handled interline between the acquirer and property acquired by another might be disadvantaged. Beyond all this we do not readily foresee the feasibility of a six or eight party management practicing a policy of strict neutrality over a system as large as this—a situation altogether different from the common joint ownership of local terminal railroads. The possibilities for friction would be endless; management might have to spend as much time quieting the sensibilities of the owners as running the railroad. In particular we perceive no likelihood of a consortium consisting of both Western and Eastern lines, since their objectives would have been directly opposed. In sum, while we cannot categorically say that the ICC would not have approved acquisition by a consortium, we think the odds would have been overwhelmingly against this outcome.[40] For these reasons we find it unnecessary to consider whether introduction of the concept of a consortium would be

inconsistent with basic notions of eminent domain law with respect to a free market.

Once the hypothetical transaction is visualized in terms of competitive bidding, the basis for Dean Jacobs' prophecy that little excess value would find its way into the hands of the Ts largely breaks down. We see no force in the GPs' contention that a railroad having an interest in acquisition would not enter the contest if it perceived that another would be likely to bid more. This assumes a degree of information about the intentions of other parties which normally does not exist. Beyond that, a railroad, even if not expecting to be successful, might have an interest in driving up the price a competitor would have to pay. The GPs correctly point out that we must consider not only competition among buyers but also competition among sellers. While no one can do more than guess, we would suppose that in a two-bidder situation, after making deduction for payments that would be required to be made to third parties, the road having the lesser interest would have bid well up toward its reservation price and the road with the greater interest would have topped this by a relatively small amount.

VI. The Effect of Inflation on Earnings Forecasts

The GPs, without quantifying the amount of the adjustment urged to be required, attack the Ts' projections because of their failure to allow for the allegedly detrimental effect of inflation on earnings. The GPs presented their evidence through a qualified witness, Russell Murphy.[41]

Murphy's thesis was that between 1967 and April 1, 1976, three separate influences had caused railroad earnings to suffer as a result of inflation and would be expected to continue to do so. These were as follows:

(1) The railroad industry voluntarily chose not to petition the ICC to recover the entirety of its inflated costs.

(2) The ICC awarded the industry less rate relief than the industry ultimately sought—partly in the interest of shippers and partly because it believed the requested increases would cause such loss of traffic as to be counter-productive. See, *e.g., Increased Freight Rates and Charges, 1975, Nationwide, Ex parte* 310, 349 I.C.C. 555, 575 (1975); *Increased Freight Rates and Charges, 1973, Nationwide, Ex parte* 295, 344 I.C.C. 589, 637 (1973).

(3) The industry, primarily because of competition from other modes of transportation, did not implement fully the rate increases that had been granted.[42]

Examining the 14 general rate increase proceedings conducted by the ICC between 1967 and April 1, 1976, he found that although the roads reported inflated costs of $10.614 billion, the roads had sought increases of only $8.255 billion, and had been granted increases of only $8.229 billion. However, because of a variety of factors—fears of loss of traffic to other modes of transportation, delay in obtaining permission to increase intrastate rates, and "accounting delay", the railroads realized only some 82 percent of the increases authorized.[43] This picture, however, had somewhat improved after 1973. In the four general rate increase authorizations for which data were reported by the industry before April 1, 1976, an average revenue yield of 92.5 percent of authorized increases was realized. R. Murphy (S) (Jan. 30, 1980) at 35-39.

The portion of EL's opening brief dealing with this subject largely contented itself with relying on testimony of James White, Chessie's Director of Cost and Economic Analysis and author of the Chessie study of EL and R, that Chessie used constant dollars because "we generally found from studies that freight revenues generally inflate, in some cases, slightly greater, but not significantly greater than do costs", White (D) (July 20, 1977) at 365-66, EL App. K at 146-47; of John Darling, Director of Cost

Analysis and Research for Santa Fe, who said that use of constant dollars was "an appropriate method of financial analysis in the railroad industry", Darling (D) (July 31, 1980) at 28, EL App. K at 150; and Frederick Smith[44] the GPs' chief valuation witness, who acknowledged that he had performed a constant dollar analysis for his employer, First Boston Corporation.[45] See 2 ELF at 410-12.

In its reply brief EL made a more extensive answer, ELRB at 172-85. This starts with an assertion that Murphy's data with respect to increased costs were based on a summary prepared in 1979 by the Association of American Railroads (AAR), which seems to have relied on the railroads' submissions in the increased rate cases. In testing his model Murphy compiled actual cost data for the railroad industry for the period 1966-76. This allegedly demonstrated that for the period preceding the Ts' proposed 1974 disposition date, 1966-73, the actual cumulative cost increases experienced by the railroad industry totaled $5,373 million, as compared to the $6,965 million reported by the AAR. The cumulative revenue increases authorized by the ICC for the same period totaled $5,573 million, so that these more than recovered the railroad's increased costs.[46] EL supports this by citations to various ICC proceedings in which the Commission found the railroad's cost claims, which were those in the AAR data, to be overstated.[47] It goes on to make three criticisms of the portion of Murphy's study concerning the relationship between increased costs and rate increases, the most important being that the study underestimated total rate increases because it took into account only general rate increases achieved in nationwide *Ex parte* proceedings, ignoring annual volume rates which are frequently subject to automatic escalation clauses and other specific tariff filings. EL contends that Murphy's conclusion that the roads did not obtain rate relief equal to their increased costs thus cannot stand.

Turning to Murphy's final point, the alleged failure of the railroads to realize the full rate relief accorded by the Commission, EL contends that the Commission took this into account in granting rate relief. Admitting that the ICC has concluded that the railroads realize only some 82 percent of the rate relief authorized,[48] EL says that the Commission grants increases such that 82 percent realization would meet increased costs, see *Ex Parte 265 & Ex Parte 267, supra,* 339 I.C.C. at 177-78; *Ex Parte* 357, 359 I.C.C. 740 (1978). In addition EL called attention to a report of a USRA panel, of which Murphy was named as a member, which minimized the fear of diversion to trucks as a factor that would prevent Conrail from raising its rates to meet inflation by saying that "the effect of inflation on the cost levels of the two modes was essentially the same". R. Murphy (D) (May 19, 1980) Ex. 52 at 4, EL App. O at 640; ELRB at 182.

We believe that EL has satisfactorily answered Murphy's claims.[49] It is clear that, at least in the cases which a buyer would have regarded as most relevant, the ICC granted increases in a nominal amount greater than the railroads' increased costs because of its perception that only a fraction, say 82 percent, would be realized. Taking, for example, the figures in note 46, the yield on authorized rate increases would be 82 percent of $8,229, or $6,748 million leaving a shortfall of $725 million. This is not a stupendous amount for the entire railroad industry over a ten year period. Even this estimate is undoubtedly too high since it does not include any allowance for specific tariff filings and automatic escalation clauses. Finally, Murphy does not and cannot answer the testimony of White and Darling, executives of railroads who were potential acquirers of EL and LV, to the effect that inflation was not a serious concern.

VII. Valuation Methodology

There are two components to be considered in valuing an asset: the amount of cash it generates and the discount rate. The first

component is obviously important—an investment yielding $100 a year is worth twice as much as one yielding $50 a year. The second component is equally important—$100 now is worth more than $100 ten years from now. All the parties agree that these are the two relevant concerns. Where they disagree is on how to measure them.

A. *DCF vs. EBIT*

The parties used essentially two different methods for valuing the earnings claimed to have been generated by the Ts' properties. The GPs, PC, and, with modification, EL determined the present discounted value of the distributable cash flow (DCF) generated by the enterprise. Under this approach, one first projects DCF for future years. DCF is essentially earnings plus after-tax interest, principal payments, and depreciation minus taxes and capital expenditures needed to maintain earnings.[50] As its name implies, DCF represents the funds that can be distributed to all investors, including bondholders, without impairing the earning power of the enterprise. The next step is to discount DCF for future years to present discounted value (PDV) using an appropriate discount rate.[51]

AA capitalized earnings before interest and taxes (EBIT) for a normalized, or average, year. L&NE capitalized earnings before interest but after taxes, assuming a 50 percent tax rate. EBIT represents what its name implies—earnings with interest, principal payments, and taxes added back in. This figure is then capitalized using an appropriate interest rate on the assumption that the enterprise will generate normalized (an average year's) EBIT in perpetuity.[52]

On balance, the court believes that the approach presented by the GPs' expert witness Smith[53] is preferable to AA's and L&NE's method. The advantages of using DCF are highlighted by examining the three key differences between the two methods:

the effect of timing, the impact of taxes, and the treatment and estimation of capital expenditures needed to maintain income.

1. *Timing*

The first major difference is that DCF relies on a series of annual projections while EBIT uses a single average year. Smith argues that by using annual projections rather than a single average year, it is easier to assess the effect of the forces that affect earnings. While we are not convinced that trying to assess the impact of these trends on twenty numbers is necessarily easier than assessing them on one, the use of annual projections does have the major advantage of allowing one to take account of the effect of time on present value.

As a rule, the earlier one realizes income the better. The use of a single normalized year blurs the effect of the timing of the receipt of income on the capitalized value of an enterprise by assuming that earnings will be realized in a constant flow. If one is able to project that some years will be better than others, while the average earnings for two companies could be the same, the capitalized value of their earnings streams could be quite different. An illustration of this is given in the margin.[54]

Of course, the GPs' witness did not assume that an enterprise would disappear at the end of twenty years. Smith assumed that the final year's cash flow would represent the expected normalized year's experience and calculated the capitalized value of that figure. The result, called the terminal value, is then discounted to PDV.[55] The total value of the enterprise is equal to the PDV of the annual cash flow projections plus the PDV of the terminal value.

While the GPs' witnesses thought that twenty or thirty-year cash flow projections would be optimal, no GPs' witness projected detailed annual cash flows for EL, LV, AA, or L&NE. Instead, the GPs relied on the projections made by the Ts themselves. EL relied on DCF for the first four years and after-tax earnings for

the fifth year. EL hypothesized that its fifth-year eanrings would represent a normalized year and calculated the terminal value of its proffer from that figure. AA and L&NE did not present any annual projections of their earnings and relied solely on an estimate of a single year's normalized earnings.

2. *Taxes*

The second major difference between DCF and EBIT is the treatment of taxes: DCF is an after-tax figure, EBIT is a before-tax figure. The GPs' expert testified that since investors are generally interested in the amount of money left over after every one else, including federal and state governments, has taken his cut, after-tax figures should be used in valuing an enterprise. We do not believe the Ts to dispute him on this point. Rather, AA, the only T other than LV[56] that used before tax figures, argued that the GPs' proposed adjustment to EBIT in their particular cases is inappropriate.

AA's expert, James Laurie,[57] argued that AA should be valued on a pre-tax basis since one of the bidders for its property, the Detroit, Toledo & Ironton (D,T&I), was tax exempt because of its significant loss carryforwards. But as the GPs point out, even if one accepts AA's contention that D,T&I would have enjoyed a tax-free status forever,[58] AA would not have gotten any benefit from that status. Any investment made by D,T&I would be worth more as a result of D,T&I's tax position. Rather than pay over the value of its tax position to AA, D,T&I would forego the purchase of AA and make other investments where it would be able to keep the entire value of its tax benefit to itself.[59]

In order to adjust AA's projection, Smith reduced AA's DCF by 50 percent, representing a 48 percent federal tax rate and an average 4 percent state tax with a credit against federal taxes. The GPs added back 4.3 percent of this after-tax figure to account for the investment tax credit. This figure was derived from the

projections for the normalized operation of the IFLs and AA does not challenge its propriety.

3. *Capital Expenditures Needed to Maintain Income*

The final and perhaps most significant difference between DCF and EBIT is that DCF explicitly takes account of the fact that a company may have to make annual capital expenditures in order to maintain earnings. The GPs present a simple example illustrating this point. Suppose there are two companies, A and B, with annual earnings of $100 a year and with no depreciation charges. Capitalizing earnings alone at 10 percent would yield a value of $1000 for both firms. Suppose, however, that company A consumes $30 a year in capital (leaving $70 in DCF) and that company B consumes $80 a year in capital (leaving $20 in DCF)—that is, in order to maintain a $100 a year in income each company has to reinvest $30 and $80 a year respectively. By taking this factor into account, it becomes clear that use of a capitalized earnings approach yields an overly high valuation. Capitalized DCF would be only $700 for company A and $200 for company B.

The illustration in the GPs' brief overstates the importance of this factor, however, since it assumes there is no depreciation. In the real world, depreciation charges against income can serve as a proxy for capital expenditures needed to maintain income.[60] EBIT is an after-depreciation figure. In addition, EBIT includes maintenance of way, another item that can properly be viewed as a capital expenditure required to maintain income. Indeed, it is conceivable that use of EBIT could result in the undervaluation of an enterprise if depreciation and maintenance of way charges exceed capital expenditures needed to maintain income.[61] The advantage of using DCF over EBIT then is not that EBIT ignores the fact that capital expenditures may be required to maintain income but that DCF explicitly includes the factor while EBIT at best includes it indirectly.[62]

While we thus agree with Smith that it is desirable to adjust EBIT to take account of capital expenditures needed to maintain income, we do not completely accept the validity of the adjustments Smith proposes. Specifically, we think that for AA and L&NE, Smith's reduction of EBIT by one-third was inappropriate. Smith derived this figure from the projected normalized earnings statements for the IFLs. Smith found that DCF equalled two-thirds of EBIT for the IFLs and assumed that a similar relationship would hold for AA and L&NE. This assumption was unjustified.

Smith testified that the bulk of his one-third adjustment was accounted for by capital expenditures, the largest part of which is made up of rolling stock. Smith (D) (Aug. 25, 1980) at 2022-34, 19 GP Supp. App. at 374-86; 2 GP at F 19 n.9. AA based its earnings study, however, on the assumption that, save for locomotives, its acquirer would have leased all the equipment it would have needed. And as Smith himself admitted at his deposition, if the "income statement correctly reflected the total amount of per diems payable, then there would be double counting" if the one-third deduction were also made. Smith (D) (Aug. 25, 1980) at 2028, 19 GP Supp. App. at 380. This is because the shortfall in allowable depreciation "will be passed on" by the owner of the car in the rental charges. Smith (D) (Aug. 26, 1980) at 2120, 19 GP Supp. App. at 399. It was improper, therefore, for Smith to reduce AA's EBIT to account for capital expenditures needed to maintain income.[63]

Smith's one-third adjustment is similarly overstated for L&NE. L&NE's witness, Jack Storm,[64] assumed that all new equipment needed by L&NE would be rented. Storm (D) (Mar. 28, 1979) at 46, L&NE App. Accordingly Smith should not have deducted one-third from L&NE's EBIT to arrive at DCF.

EL stands on a different footing. It posited that the acquirer of its lines would have purchased new equipment and would have financed those purchases by issuing equipment trust certificates.[65]

EL deducted interest and principal payments on these certificates to derive what it calls levered cash flow. The GPs' expert testified that the acquisition cost of new equipment should be charged against cash inflow in the year that it was acquired. In order to convert EL's figures, Smith performed a two-step adjustment. First, he added interest and principal payments on new equipment back into the EL's figures. Smith next subtracted the acquisition cost of new equipment. Smith (S) (Jan. 30, 1980) at 24[illegible] *id.* at Ex. GPS-Smith (II)-31. This yields what the GPs call an unlevered cash flow.

At times it has seemed to the court that the parties have argued that one or the other approach was the "correct" one. See, *e.g.*, 2 ELF at 441-42; Smith (S) (Jan. 30, 1980) at 249. The GPs' reply brief and oral argument make it clear, however, that both sides agree that it is proper to use either a levered or unlevered cash flow in valuing an enterprise as long as a debt-to-equity ratio and cost of debt consistent with that assumption is used and that either approach, properly applied, will yield the same result. 1 GPRB at F 56-58; Tr. at 70-73 (EL), 282-86 (GPs). There will be further discussion of the debt-to-equity ratio and cost of debt at pp. 57-59, 65, *infra*. Suffice it to say here that the parties agree that if the effect of equipment financing is accounted for in the cash flow, then the debt-to-equity ratio and cost of debt should exclude equipment debt. Similarly, if an unlevered cash flow is used, equipment debt should be included in the ratio and cost of debt. The choice between levered and unlevered cash flows then boils down to one over the proper debt-to-equity ratio and cost of debt. We opt for the use of unlevered cash flows. This is because, as our full discussion of debt-to-equity ratios will reveal, we accept the GPs' approach to choosing the proper ratio, and the ratios the GPs ask us to consider include equipment obligations. Rather than adjust those ratios, we think it is easier to adopt the GPs' methodology.

The other difference between the approaches of the GPs and EL is that EL capitalized fifth-year earnings while the GPs capitalized fifth-year unlevered cash flow. As already discussed, we think it is preferable to use DCF. EL argues, however, that Smith's use of EL's own projected fifth-year cash flow was improper. Smith calculated the PDV of the first four years' projected unlevered cash flows and added to that the PDV of the capitalized value of the fifth-year's unlevered cash flow. Implicit in this approach is the assumption that fifth-year cash flows represented cash flows for a normalized year. EL argues that this assumption was unfounded. Tr. at 77-78.

Shannon testified that fifth-year *earnings* for EL were normal because by that time the acquirer of EL's lines would have completed its rehabilitation program and would have fully realized the projected savings from merged operations. Shannon made no judgment as to whether fifth-year cash flow, as opposed to fifth-year earnings, represented a normal year's experience. EL claimed that projected fifth-year capital expenditures did not represent the normalized experience because Shannon's replacement schedule for EL's car fleet was based on a 23-year replacement cycle whereas the useful life of this equipment is 28 to 30 years. El concluded that fifth-year equipment acquisition levels are higher than normal and that, therefore, the fifth-year cash flow understates the "normalized" cash flow. *Id.*

Since this argument had not been fully addressed in the briefs, the court in a letter dated June 25, 1981, asked counsel for EL to submit a statement giving more details of and record support for their contentions. EL submitted a statement to the court on July 10, 1981, Sp. Ct. Rep. N 36191, and the GPs responded on July 17, 1981, Sp. Ct. Rep. N 36300. An examination of these statements and the accompanying workpapers reveals that Shannon did not assume an accelerated replacement program. Instead, he explicitly assumed that a normal schedule would require the annual replacement of 4 percent of the EL's total car fleet. This

translates into a 25-year replacement cycle, a schedule comparable to the projections made by other witnesses. Smith was perfectly justified, therefore, in treating the fifth-year cash flow as representing a normal year's experience.

B. *Discount Rate*

In the previous discussion, we have frequently alluded to an "appropriate interest rate". Not surprisingly, the parties differ as to what that rate should be. The GPs' lead witness on the subject, Smith, opined that the proper rate would be 10.66 percent assuming a July 1, 1974, disposition and 10.45 percent assuming an April 1, 1976, disposition. EL's witness, Percy Young, Jr.,[66] applied a 6 percent discount rate to the first four years' DCF and capitalized fifth-year earnings at 10 percent.[67] AA's witness, Laurie, used a 7.5 percent capitalization rate[68] and Storm, L&NE's witness, used a 10 percent rate. Neither Laurie nor Storm, however, gives any justification for his choice of interest rate.[69]

The witnesses who did give detailed consideration to this question, Young for EL, Smith, Dr. Richard Roll,[70] and Dr. Richard Meyer[71] for the GPs, and Paul Hallingby, Jr.[72] and Dr. Stewart Myers[73] for PC agreed that the appropriate interest rate for discounting DCF could be derived by calculating the average weighted cost of capital (AWCC). AWCC is made up of three components: cost of equity, cost of debt, and debt-to-equity ratio. Calculation of AWCC requires an average of the cost of debt and cost of equity, weighted by the percentage of debt and equity in the capital structure. So, for example, if the cost of debt is 5 percent and cost of equity is 10 percent and debt comprises 50 percent of the capital structure, AWCC is 7.5%—$(.5\times.05)+(.5\times.10)$.[74]

Cost of debt and cost of equity are both made up of three factors—the risk-free rate of interest, an inflation component, and a premium compensating the investor for risk. The risk

component is the only one unique to each enterprise, however. Risk is essentially an assessment of the likelihood that the true outcome will differ from the expected outcome. So, for example, if there are two investments that are both expected to generate a DCF of $10 a year on average, but one is expected to have a constant return and the other a variable return, the second investment would be considered riskier. Given a choice between the two investments with the same price, a rational investor would chose the one with the more predictable yield. In order to induce an investor to purchase the riskier asset, its purchase price must be lower than that of less risky assets with the same DCF. A lower purchase price translates into a higher rate of return on the riskier asset. The degree of risk also affects the debt-to-equity ratio—the greater the risk, the less debt the company can carry and still maintain the same cost of debt.

The Ts' witnesses testified that a purchaser of the proffered lines would view the investment as having the same level of risk as an investment in an average risk security. The GPs' witnesses testified that an investment in the Ts' properties would involve a greater than average amount of risk. On balance, we consider that the conclusion is almost inescapable that a purchaser of the Ts' lines would have viewed the investment as having a greater than average amount of risk. We believe, however, that the GPs' witnesses overstate the risk premium associated with an investment in the Ts' lines. Accordingly, we have no choice but to discuss each of the three components that make up AWCC and derive our own discount rate.

1. *Debt-to-Equity Ratio*

The first component we consider is the debt-to-equity ratio because the cost of debt and the cost of equity both depend on that number. The relationship between the debt-to-equity ratio and the cost of debt and equity is a simple one. Debt is generally cheaper than equity for two reasons. First, because bondholders

have first claim on the assets of the company, there is less risk that, in liquidation or reorganization, bondholders will not recoup their investments with interest. Second, because interest payments are tax deductible, the effective cost of debt is reduced to the company.

One might think, then, that the optimal strategy would be for a company to reduce its total cost of capital by weighting its debt-to-equity ratio heavily in favor of debt. There are two limits to this however. First, as the percentage of debt in the capital structure increases, so does the probability that the company will not be able to meet its interest and principal payments. The probability that bondholders will not recoup their investment in the event of liquidation or reorganization also increases. The increased riskiness of the debt translates in the marketplace to a higher interest rate so the cost advantages of debt tend to disappear as the proportion of debt in the capital structure increases.

The riskiness of equity investment also increases as the debt-to-equity ratio goes up. Since a stockholder's interest is in the cash generated by the enterprise after bondholders have been paid, the greater the percentage of debt the greater the volatility in the stockholder's interest. To illustrate, assume two companies are expected to generate DCF of $100 a year. Company A has no debt, Company B is 80 percent debt financed, and pays $80 a year to bondholders. If actual earnings are 10 percent less than expected, the shortfall to an equity investor in Company A from his expected return is also 10 percent. But for an equity in Company B, the shortfall is 50 percent—he expected $20 and received only $10. The same phenomenon occurs on the upside as well—an unexpected 10 percent increase in earnings results in an unexpected 50 percent gain to equity investors in Company B.

In selecting a debt-to-equity ratio, the witnesses uniformly start with the average ratio for railroads as a group. Roll, the GPs' witness, testified that based on book value for all five samples of railroads he examined, railroads in the mid-1970's were financed with roughly 40 percent debt and 60 percent equity.

Roll (S) (Jan. 30, 1980) at 112. Smith determined that railroads that had A-rated senior mortgage debt from 1966-75 generally maintained ratios of debt to total capitalization of 30-35 percent. Smith (S) (Jan. 30, 1980) at 80-81. Stewart Myers, a witness for PC, estimated that the average debt ratio for ten large railroads making up the S&P 10-railroad index from 1969-74 was about 45 percent. Myers, however, calculated this debt ratio using estimated market values of equity and debt rather than book values. All the witnesses included equipment debt in their ratios. Our first step, then, is to choose between book- and market-valued ratios.

Stewart Myers states flatly that "the relevant measures of the debt and equity proportions are the market values of debt and equity." Myers (S) (Dec. 1, 1978) at App. C-1. No further justification is given. However, Smith tells us that bond rating agencies primarily rely on book values. It seems likely, therefore, that an acquirer of the Ts' lines would have made its capitalization decision on the basis of book valued debt ratios of comparable lines. Smith (S) (Jan. 31, 1979) at 36.[75]

Assuming that book-valued ratios are the relevant figures, we must still choose a number. We believe that Smith made a convincing case for the use of a 30 percent debt ratio. Smith based his argument on the assumption that an acquirer would have sought an A rating on its senior mortgage debt. Smith thought that there would be two related advantages to an acquirer in seeking an A rating. First, he noted that debt rated at less than an A rating was far more difficult to market than higher rated bonds at the relevant times. In turn, this difficulty became reflected in the interest rates investors demanded. See Smith (S) (Jan. 30, 1980) at 143-44. Since the A-rated railroads that Smith examined had a book valued debt ratio of 30-35 percent including equipment obligations, and since the Ts' lines would have been viewed as riskier than a typical A-rated road, an assumption with which we agree, see pp. 62-65, *infra*, Smith concluded that an acquirer would have used a debt ratio at the

low end of this range. See Smith (S) (Jan. 30, 1980) at 80-83. For the purposes of our analysis then, we will assume that acquirers of the Ts' lines would have ultimately financed their acquisitions using 30 percent debt and 70 percent equity.[76]

2. *Cost of Equity*

In estimating the cost of equity three factors must be considered: the rate of return demanded by investors for average-risk stocks, the riskiness of railroad stocks relative to average-risk stocks, and the riskiness of an equity investment in the Ts' lines relative to railroad stocks. We will refer to the two additional risk factors as railroad risk and special risk. There is rough agreement among the experts on the rate of return on average-risk investments. The GPs' witness, Smith (S) (Jan. 30, 1980) at 61, and PC's witness, Myers (S) (Dec. 1, 1978) at 29-34, both relied on a study performed by Ibbotson and Sinquefield[77] which found that, for the period from 1926 to 1976, the real rate of return for the Standard & Poor's index of 500 stocks was 9.2 percent.

The experts disagree over whether an investment in the Ts' lines would be viewed by a purchaser as entailing a greater than average risk. Smith concluded that railroad stocks as a group involve greater than average risk and that an investment in the Ts' lines in particular would involve still greater risk. He stated that the Ts' lines should be assigned nominal costs of equity ranging from 20 to 25 percent.[78] For valuation purposes, he settled on the average, 22.5 percent, as the nominal cost of equity as of April 1, 1976, which translated into a nominal cost of equity of 21.98 percent as of July 1, 1974.[79] The Ts' witnesses testified that investment in the Ts' properties would not be viewed as entailing any additional risk.

Smith did not quantify how much of his additional risk premium consisted of railroad and how much of special risk. Nonetheless, by examining the arguments and statistical evidence offered in support of Smith's conclusion that an investment in the Ts' properties would involve both railroad and special risk we can come to a judgment as to the reasonableness of Smith's conclusion and as to what the proper discount rate should be.

(a) *Railroad Risk*

Smith enumerated a long list of factors supporting his conclusion that investment in the railroad industry is riskier than investment in an average-risk industry. He stated that:

> the returns earned by railroads are impacted to a greater extent than most businesses by a combination of factors beyond their control, including economic cycles, inflation, government transportation policy and regulation . . . competitive considerations, capital intensiveness, labor intensiveness, and adverse weather.

Smith (S) (Jan. 30, 1980) at 45-46. Whatever the merit of Smith's judgments as to the respects in which railroads are riskier than average,[80] Smith also admitted that in numerous respects railroads were less risky than average. For example, Smith admitted that railroads are essentially immune from the risks associated with dealing directly with consumers or with being in a field with rapid technological change. See 2 ELF at 420-21. Simply as a matter of judgment, then, it would seem to be a very difficult task to weigh all the relevant factors and state confidently that an industry is more or less risky than average.

This is one area, however, where the court need not rely solely on an expert's personal judgment. Statistical analysis is available and was offered by the parties to determine whether railroad

stocks as a group have historically yielded higher rates of return to compensate investors for higher than average-risk. The parties have generally avoided heavy reliance on this material in their briefs for fear of burdening the court with the detailed and admittedly technical debate among three experts which spans four volumes of testimony. Likewise, we will not encumber this opinion with a lengthy discussion of this evidence.

Briefly, PC's witness, Stewart Myers, estimated two commonly used measures of risk, standard deviation of the annual rate of return and beta, for a representative sample of large railroads. Beta measures the amount of risk which a stock contributes to a portfolio made up of a large number of stocks. Both measures showed that railroad stocks were average-risk investments. The GPs' witnesses offered several criticisms and refinements of Myers' study. None of this evidence gives us any reason to question Myers' conclusions.

The GPs' witness, Roll, proposed another measure of riskiness which he called "excess return", and estimated that railroad stocks commanded a 6.14 percent premium over average risk stocks for the 1969-74 period. In essence, excess return is the difference in risk premium between an average-risk stock and the stock or stocks being studied. But Roll's estimates of excess returns were not statistically significant—that is, one could not say to an acceptable degree of certainty that Roll's findings were not attributable to random fluctuations. And their values varied widely depending on the period studied, so much so that for the years 1964-69 excess returns were negative. In sum, despite their impressive efforts, Roll and Richard Meyer have failed to develop evidence which would lead us to reject Myers' initial conclusions.

(b) *Special Risk*

While we reject the GPs' contention that railroad stocks as a group are relatively risky investments, there can be no doubt that,

as the GPs' brief puts it, "[b]oth the record and simple common sense", 1 GPRB at E 79, indicate that potential acquirers of the Ts' lines would have viewed such investments as being of above average risk. However, we believe that Smith overstated the special risks attending the Ts' properties.

Smith initially made his risk assessment for the IFLs and went on to assume that the Ts' properties were equally risky, see note 78, *supra*. In reviewing the three major reasons he gave for the IFLs' special risk the court is convinced that, although the Ts' properties share the same characteristics that contributed to the IFLs' peculiar riskiness, Smith's blanket conclusion that the Ts' lines were as risky as the IFLs was unfounded.

The first factor Smith identified is that the Ts' properties were all located in the Northeast. Smith argued with considerable force that:

> . . . Class I railroads in the Northeast on average were characterized by less favorable operating margins, lower returns, less growth and less financial resiliency than observed elsewhere in the industry. . . . Rail operations in the Eastern District (roughly, the Northeast region) were particularly vulnerable to competition from the trucking industry, and were characterized by relatively higher terminal costs, shorter average lengths of haul, and higher labor costs than rail operations elsewhere in the country. These factors contributed to an increased volatility of railroad financial performance. . . .

Smith (S) (Jan. 30, 1980) at 46-47. But, as the transcript of his deposition reveals, Smith (D) (Aug. 21, 1980) at 1624-27, EL App. J at 337-40, when Smith said "railroads in the Northeast", he meant bankrupt railroads in the Northeast. The financial performance of Norfolk & Western, C&O, and B&O all compare favorably with Western and Southern railroads. Smith argued, however, that the profitable Eastern carriers as a group were not

comparable to the bankrupts. For example, he stated that the Norfolk & Western and C&O were heavily into transporting coal, a service which is virtually immune from trucking competition. Smith (D) (Aug. 21, 1980) at 1625, EL App. J at 335. And as Smith points out, there is no getting around the fact that at that time the major railroad bankruptcies had occurred in the same region and that this supports an inference that railroads operating in the Northeast shared common problems.[81] Saying this, however, does not mean that all the Ts would be viewed by potential acquirers as suffering from these problems to the same extent as PC.

This difference is highlighted by the next factor Smith cites. He claims that potential acquirers would view investment in the Ts' properties as particularly risky because the railroad industry in the Northeast would be radically reconfigured in an attempt to overcome all of the problems previously discussed. Again, to a certain extent, Smith is correct. Even without the uncertainties introduced by the creation of the JTs, the transformation would have been striking. Approximately one-third of the combined trackage of EL and LV would have been abandoned. New owners, new routings and new competitive relationships would have all contributed to the ensuing uncertainty. But while the restructuring of EL's and LV's lines would have been considerable, it pales in comparison to that envisioned for PC. In the alternative scenario, PC posited that 16,000 miles out of its 26,000-mile system would have been abandoned. The scope of the adjustments necessitated by PC abandonments would have been far greater than those for the other Ts. Smith admitted at his deposition that "Erie was just, on a raw basis, in terms of mileage, not be reconfigured to the same extent, as certainly the IFL." Smith (D) (Aug. 8, 1980) at 757-58, EL App. J at 165-66. And the complexities and uncertainties attendant on the restructuring of a 26,000-mile system cannot be compared to the simple single-line proffers made by AA and L&NE.

To be sure, Smith correctly points out that wholly apart from uncertainties created by the restructuring of their own lines, the extensive abandonments and restructuring of PC's lines would have created problems for the purchasers of the other Ts. But this factor cuts both ways. Laurie, EL's witness on traffic, projected that while EL would lose 17,000 cars annually due to PC's abandonments, EL would gain over 50,000 new cars. Laurie (S) (Dec. 30, 1978) App. 1 at 4.

Finally, Smith reasoned that potential acquirers would assign a higher discount rate to the Ts' lines because "property with which a potential purchaser railroad does not have significant experience or any historical reference point—will be treated with less confidence." 2 GP at F 54. Again, we accept Smith's general proposition but do not believe that the Ts' lines stand on the same footing as the IFLs. As EL and AA point out, in contrast to the IFL case their projections are based on verifiable historic traffic and cost data. While potential acquirers of the Ts may not have had significant first hand operating experience with those lines, this does not mean that all projections would have been viewed as having the same inherent unreliability.[82]

One benchmark we have not yet considered is the costs of equity that Smith actually employed in his valuation of five other rail acquisitions conducted at various times from 1976 to early 1980. The average rates he has used ranged from 16.5 percent to 19 percent. Although EL argues that we should reject this testimony because of Smith's failure to give significant details about how those numbers were derived, see ELRB 159-62, keeping these numbers in mind gives a feel for what real world numbers are like.

The court is left then with the difficult task of choosing a discount rate based on an informed judgment as to what factors to consider and as to the riskiness of the Ts' lines relative to the IFLs. The range we consider runs from 16 percent, the rate of return on average-risk equity investments, to 25 percent, the highest rate considered by Smith. We do not think it worthwhile

to attempt to derive different rates for different Ts since, all things considered, we do not think we will find much to distinguish them. While AA and L&NE may have the simplest proffers, Smith points out, Smith (S) (Jan. 30, 1980) at 293, that their small size creates an entirely different set of risks. And relative to AA and L&NE, the EL-LV package has neither any particularly positive nor negative factors. To be sure, no number which we choose will be "correct" since we are making a subjective judgment as to what the subjective judgment of a potential acquirer would have been. On balance, however, we think that 20 percent is a reasonable estimate of the cost of equity for the Ts' lines as of January 1, 1974, assuming 30 percent debt financing.[83]

3. *Cost of Debt*

The final component in determining AWCC is the cost of debt. As previously discussed, the 30 percent debt ratio that we have used assumes that senior mortgage debt would be A-rated. According to Smith, senior mortgage debt would make up one-third of the total debt. The other two-thirds would be made up of equipment trust certificates. The certificates would be Aa-rated. Equipment debt is generally rated one grade higher than senior mortgage debt because it is better secured and because it receives favorable treatment in bankruptcy. No witness provided us with estimates of what the yield on railroad bonds would have been.[84] However, we do have two tables prepared by the GPs' witness Roll, Roll (S) (Jan. 30, 1980) at 87, 97, which show the yields of various railroad bonds. The tables show that on January 15, 1974, Burlington Northern issued A-rated, non-convertible senior mortgage debt with a yield of 8.6 percent and that on the same date, Norfolk & Western issued Aa-rated equipment trust certificates yielding 7.9 percent. We believe that a prospective acquirer would have viewed these as reasonable estimates of their cost of debt capital. Taking a weighted average of these rates gives us an 8.13 percent pre-tax cost of debt as of January 1, 1974.

Only one further adjustment needs to be made. The cost of debt which we have so far discussed is pre-tax. However, since interest payments are tax deductible, the relevant measure is the after-tax cost of debt. All of the witnesses who have considered this have assumed a 50 percent marginal tax rate and have accordingly reduced the cost of debt by one-half.

4. *Calculating AWCC*

We now have all the necessary ingredients. The table below shows how AWCC for January 1, 1974 is computed.

AWCC as of January 1, 1974

Weighted cost of equity		*Weighted after-tax cost of debt*		*AWCC*
(20 x .70)		(4.067 x .30)		
	+		=	15.22
14		1.22		

The AWCC which we have so far calculated is stated in nominal terms. The cash flow projections are stated in constant dollars. We therefore need to factor out the inflation component from the rates. Using Smith's assumption of a 5.58 percent long term inflation rate for 1974, Smith (S) (Jan. 30, 1980) at 54, we derive a real AWCC of 9.13 percent as of January 1, 1974.

VIII. Rehabilitation Costs and Maintenance of Way Expenses

The GPs and each T provided estimates for the rehabilitation costs (RC) and annual maintenance of way expenses (MOWE) necessary to restore and maintain the properties they proffered for continued rail use. The GPs obtained their estimates from a study conducted expressly for this litigation by Sverdrup & Parcel and Associates, Inc. (S&P), consulting engineers.[85] The Ts obtained their estimates from studies conducted in-house, studies

by outside consultants, and studies by potential acquirers. That the methodologies of the various studies differ markedly is not surprising. What is surprising is the extent to which the results differ.[86]

The differences in method between S&P's study and the various studies of the Ts are too substantial to allow us to compare the studies item by item and to extract a composite figure for RC and MOWE that melds the results of each. Rather, we have examined each study individually to determine its reliability in the light of the shortcomings pointed out by its opponents, with a view toward selecting the more reliable study and adjusting it for whatever errors are uncovered. For the reasons set out below, we conclude that the GPs' study does not withstand scrutiny. We therefore accept the studies submitted by EL, LV, and AA as the starting point for deciding the RC and MOWE expenses facing the potential acquirers of those Ts' lines.

A. *The Government Parties' Study*

The methodology employed by S&P in conducting its study is detailed extensively in two multivolume reports prepared by S&P and introduced in evidence by the GPs. See Rehabilitation Study for United States Railway Association, January 31, 1979 (1979 Study), and Rehabilitation and Maintenance Study for United States Railway Association, January 30, 1980 (1980 Study).[87] The two principal architects of the S&P Studies were H. Porter Morgan, who was in charge of all track related items, and Roy Gunderson, who was in charge of bridges and tunnels. Both Morgan and Gunderson had extensive experience in railroad maintenance.[88]

Morgan and Gunderson began by dividing the Ts' rail facilities into four major categories—track, bridges, yards, and signals. Drawing upon a variety of sources, see 1979 Study at III, they developed standards and criteria to be used in defining the level to which these rail facilities should be restored and maintained.

Morgan and Gunderson then set out to determine the condition of the Ts' lines as they existed in 1974. Because they did not begin their study until four years later, any new data they could have collected concerning the condition of the railroads would have had to be adjusted to account for the deterioration that occurred and the maintenance and rehabilitation that was undertaken in the intervening years. Rather than undertake this difficult and uncertain process, they obtained their raw data from a study, commonly known as the Bechtel Study, which was commissioned by the USRA during its preparation of the FSP and which was conducted in 1974 and 1975. The data generated for the Bechtel Study were obtained from inspections, interviews with key railroad personnel, maintenance charts, and other company records.

Extrapolating from this Bechtel Study data, Morgan and Gunderson attempted to assess the condition of each T's lines. They determined how much work was necessary to restore the lines to the levels dictated by the standards they had developed, and defined these rehabilitation requirements in terms of units called "work functions".[89] Morgan and Gunderson also developed unit cost figures for each work function. Straightforward calculations based on their projections for the total number of units of work needed and the costs attributable to those units of work yielded RC figures for each proposed acquisition hypothesized by the Ts in the alternative scenario. A similar set of calculations based on projected annual maintenance needs yielded a corresponding set of annual MOWE figures. See H. Morgan Corrections (S) (June 6, 1980) at Tables VIII-2aA, VIII-2bA.

The S&P methodology is not inherently weak. As applied, however, it yielded questionable results. In three of the four major areas of rehabilitation studied by the S&P team—track, bridges, and yards—sampling errors, incorrect use of standards, and inaccurate data undermined the reliability of S&P's results.

Appendix H

1. *Track*

With one exception, S&P's estimates for track rehabilitation constituted the largest portion, in some cases over 50 percent, of every T's total RC. See 2 GP at E 10-11. The Ts catalogue numerous errors in the methods S&P used in making its estimates of track rehabilitation. The asserted errors relating to three portions of the track study—rail replacement, turnouts, and crossings—bear detailed discussion.

(a) *Rail Replacement*

Just as track rehabilitation generally constituted the largest portion of each T's total RC, rail replacement constituted the largest single item of track rehabilitation.[90] For the reasons explained below, Morgan overstated the rail replacement needs of the Ts.

i. *Vertical Headwear.* Headwear refers to the wear to the surface of the rail that comes in contact with a train's wheels. Although this surface of the rail wears both horizontally, affecting the width—or gauge—of the rail, and vertically, the controversy over headwear in this case is confined to vertical headwear. The rate of headwear depends primarily on the speed and weight of the traffic that runs over it. When the headwear on rail used in heavy, high-speed traffic reaches certain levels, considerations of safety and economics demand that it be removed and relaid in areas of lighter use, such as secondary lines, branch lines, and yards.[91] In making his rail replacement decisions, Morgan relied on a table of headwear standards developed by the American Railway Engineering Association (AREA).[92] Morgan misapplied these AREA standards, however, in three important respects.

Morgan's first error concerns his interpretation of the AREA figures. The AREA table sets out four classes of use for rail: main line (Class I), branch line (Class II), light branch line

(Class III), and yards (Class IV). For each class, the table assigns figures for maximum allowable headwear, both vertically and horizontally, for various weights of rail.[93] For example, the table sets out the following figures for maximum vertical headwear on 140-pound rail:

Class I	¼ inch
Class II	⅜ inch
Class III	⅝ inch
Class IV	¾ inch

1979 Study at III 30.

Morgan interpreted the AREA table to mean that as headwear on the Ts' rails in each class approached the allowable figures, it should be removed and relaid in the next lower class.[94] Thus, as Morgan interpreted the table, 140-pound rail in Class I use should be removed and relaid in Class II use when the headwear approaches ¼ inch; rail in Class II service should move to Class III service when headwear approaches ⅜ inch. This interpretation and application of the AREA standards is directly opposed to the views of other railroad engineers. When the Bechtel Study was completed, Bechtel had a group of six railroad engineers review and assess the work of the various engineering firms who had done the leg work for the study. Those engineers had this to say about the AREA table:

> [T]he table actually recommends the limits of rail wear for various classes of service at which it is economically feasible to remove bolted rail from track, weld it and replace it in track of the same class service rather than requiring removal from track to a lesser class of service.

H. Morgan (D) (May 7, 1980) Ex. 109, EL App. E at 198. Under this interpretation of the table, even if the table is used as a guide for determining when to remove rail, a purpose for which it was not intended,[95] Class I rail can still be economically relaid in

Class I service as wear approaches ¼ inch; it is not until wear exceeds ¼ inch that relaying in Class I service becomes uneconomical because its useful life would be too short. Indeed, if Class I rail is destined for Class II service, the table indicates only that for economic purposes the rail need not be removed from Class I service until wear approaches ⅜ inch.

The GPs make no attempt to defend Morgan's interpretation of the AREA table. Nor do they quarrel with the Bechtel consultants' explanation of the proper use of the table. See 3 GPRB at App. A 41-42. Instead, the GPs' line of defense is that Morgan did not make rail replacement decisions solely on the basis of headwear; headwear was but one of a number of factors considered. Nevertheless, Morgan and one of the two assistants assigned to making rail replacement decisions admitted that headwear was a major factor in making those decisions.[96] See H. Morgan (D) (Apr. 14, 1980) at 201-02, 216, 28 GP Supp. App. at 6-7, 14. By analyzing a major factor like headwear under standards that were more strict than those used in the industry, Morgan and his assistants would have replaced rail prematurely, thereby inflating the cost of rehabilitation.

The second way in which Morgan misapplied the AREA table was by misclassifying the Ts' lines. The AREA table sets out four classes of track use. The table gives no guidance, however, in determining the appropriate classification for a particular rail line. Morgan used traffic density, measured in millions of gross tons per year (MGT), as the determinant. Using traffic density to classify railroad lines is an acceptable practice. The problem arises from the density figures Morgan chose. Morgan classified the Ts' lines as follows:[97]

Class I	10 or MGT
Class II	1 to 9.9 MGT
Class III	0 to 0.9 MGT

1979 Study at III-32. In contrast, given the speed limits on the Ts' lines, the Bechtel Study used the following classification:

Class I	20 or more MGT
Class II	5 to 19.9 MGT
Class III	0 to 4.9 MGT

ELF at 163; H. Morgan (D) (May 7, 1980) Ex. 108, EL App. E at 187. As is obvious from a comparison of the two tables, Morgan's scheme places track between 10 and 19.9 MGT and track between 1 and 4.9 MGT in higher classes than they were placed in Bechtel's scheme. Since headwear standards become more strict as the class of service increases, Morgan's classification subjects all the Ts' lines within those density limits to more restrictive headwear standards than would be the case under Bechtel's classification. The inevitable result is that more rail replacement is called for under Morgan's approach than that of Bechtel.

On the record before us, we cannot definitively say which is the correct classification scheme since the AREA does not set out the densities for its classifications. For several reasons, however, we conclude that Morgan's figures are too conservative. First, the Bechtel Study was performed by disinterested parties for the FSP. Second, the Bechtel classification scheme was specifically approved by Chessie engineers who made their own independent study of the rehabilitation needs of some of the Ts' lines. Chessie System Preliminary Engineering Plan for Selected Property Acquisitions of Erie Lackawanna, Penn Central, Reading (Chessie Study), EL App. B at 211. Morgan in contrast offered no support, other than his own expert judgment, for the reasonableness of his classifications.

The third problem with Morgan's application of the AREA tables is his use of inaccurate data concerning the actual density of traffic on a number of the Ts' lines. For example, Morgan

assigned excessive densities to 13 of the 27 EL lines in the Western acquisition for which he had inspection data.[98] See 1 ELF at 169 & n.132. According to the GPs' own estimates, more than 27 percent of the rail replacement in the EL Western acquisition in Morgan's study occurred in lines where densities were overstated. 3 GPRB at App. A 49. Morgan admitted that 280 of the 390 miles of LV track he would replace were on lines where correction of his density errors would have reduced the applicable AREA classification. H. Morgan (D) (Aug. 13, 1980) at 4026, EL App. D at 469. Although Morgan contended that correcting the densities would not have had a significant impact on his rail replacement decisions because headwear was but one factor, H. Morgan (D) (Aug. 13, 1980) at 4026-27, EL App. D at 469-79, he had no basis for that opinion because he did not know how many rail replacement decisions he would have had to change. Indeed, he could not know without reanalyzing those miles of track, H. Morgan (D) (May 5, 1980, Aug. 13, 1980) at 2571-72, 4027-28, EL App. D at 56-57, 470-71, something he did not do. By classifying substantial portions of the Ts' lines in higher classifications than they belonged, Morgan derived rail replacement figures that were too high.

ii. *End Batter and Mismatch.* "End batter" and "mismatch" were two of the other factors Morgan and his assistants relied on in making rail replacement decisions. End batter is the deterioration of the ends of bolted rail, and mismatch is a difference in height between the ends of two abutting lengths of rail. Morgan adopted generally accepted standards published by the Federal Railroad Administration (FRA), which assign the maximum allowable limits for these two types of wear depending upon operating speed. Morgan's team would have replaced or repaired rail that exceeded one half these FRA limits. 1979 Study at III 40.[99]

As with his density classifications, Morgan's FRA speed classifications for a number of the Ts' lines were incorrect. For example, over 900 miles of EL track in the Western acquisition were misclassified. See H. Morgan (D) (Aug. 13, 1980) at 3988-4008, 4014-15, EL App. D at 431-51, 457-58; 1 ELF at 196 & n.157. By the GPs' own calculations, almost 38 percent of the rail to be replaced in the EL Western acquisition was located in lines where the speed class was too high. Again, Morgan was unable to state how much his rail replacement decisions would have been affected had he classified the lines properly. Nor did he attempt to reanalyze those decisions after these errors were pointed out, H. Morgan (D) (Aug. 13, 1980) at 4016, EL App. D at 459, even though he made adjustments in some of his other calculations to take account of these errors. H. Morgan Corrections (S) (June 6, 1980) at 7. As in the case of the density errors, misclassifying the rail as to operating speed subjected the rail to higher standards than necessary and therefore inflated rail replacement needs.

There were other errors in Morgan's study that increased rail replacement estimates. For example, his study called for the replacement of rail on nonexistent lines and on lines where maintenance was conducted by railroads other than the Ts. 1 ELF at 183-84. We could perhaps adjust those errors. The four major errors detailed above, however, cannot be corrected without redoing the study line by line. Those errors substantially overstated the Ts' rail replacement needs.[100] A comparison of Morgan's estimates for rail replacement with the figures proposed by the Bechtel Study reinforces that conclusion. For EL and LV, Morgan called for the replacement of between 40 and 60 percent of the rail on the proffered lines; the Bechtel Study, on the other hand, called for replacement of only 7 percent. See 1 ELF at 157.[101]

Appendix H

(b) *Turnouts and Crossings*

Turnouts are switches that divert trains from one line of track to an adjoining line. Crossings are the points where a rail line intersects with either another rail line or a highway. S&P's estimates for the cost of rehabilitating the Ts' turnouts and crossings are not as large as its estimates of rail replacement costs. The figures are nevertheless substantial.[102] The methodological shortcoming that undermines these figures is the use of questionable sampling techniques for obtaining data on the condition of these items.

The sampling technique recommended by the Bechtel Study called for obtaining data from 10 percent of all the Ts' turnouts except yard turnouts. The sample turnouts were to be randomly selected and evenly distributed over the Ts' lines. See 1 1979 Study App. at III-1-15. Morgan admitted, however, that the Bechtel data he relied on did not meet the recommended 10 percent sampling rate. On the EL and LV acquisitions, his samples ranged from only 3.3 to 5.9 percent. H. Morgan (D) (Apr. 30, 1980) at 2405-09, EL App. D at 15-19. Moreover, the sampled turnouts were not evenly distributed over all EL and LV lines; some lines were entirely unrepresented, while as many as 33 percent of the turnouts on other lines were used in the sample. H. Morgan (D) (Apr. 30, 1980) at 2409-17, EL App. D at 19-27.

The S&P RC estimate for the highway crossings of at least one T, LV, is based on an even more questionable sampling technique. Data were available on only three of an estimated 329 highway crossings on LV lines in one of the EL-LV acquisitions. All three were located on a branch line. The Bechtel Study had determined that they should be replaced. On the basis of that sample, and the Bechtel Study's recommendation, Morgan decided to replace all 329 crossings. See H. Morgan (D) (Apr. 30, 1980) Ex. 67, EL App. E at 90-91. Morgan later conceded that this was not a reliable sampling method. H. Morgan (D) (Apr. 30, 1980) at 2472-73, 28 GP Supp. App. at 228-29.

The meager nature of these samples, both for turnouts and for highway crossings, as well as the willingness to rely on such limited data in assessing substantial rehabilitation sums to the Ts, does not inspire confidence in the accuracy of the S&P estimates, and indeed indicts the S&P Study in general. That these sampling problems introduced errors in favor of the GPs is confirmed by a comparison of S&P's estimate for these items with the numbers generated by a potential acquirer that had no motive to understate costs. Chessie estimated that turnout replacement on the EL lines in the Chessie acquisition would cost $326,100. Chessie Study, EL App. B at 221. In contrast, the S&P estimate was almost $6 million before salvage credit. H. Morgan (D) (Aug. 22, 1980) Ex. 280, EL App. E at 278-80 (Proffer Code 83). Chessie's estimate for highway crossings was $400,000, EL App. B at 221, while S&P's was over $3 million. H. Morgan (D) (Aug. 22, 1980) Ex. 280, EL App. E at 280.

2. *Bridges*

Gunderson headed the S&P team in charge of producing bridge RC estimates on the Ts' lines. The Ts launch a broad attack on the methods and results of these estimates, illuminating errors in all phases of the study. We find it necessary to focus on only one error in reaching our conclusion to reject the S&P estimates.

Like Morgan, Gunderson obtained virtually all of his data from the Bechtel Study. Gunderson (S) (Jan. 30, 1980) at 24-25. The six engineering firms hired to do the Bechtel Study conducted inspections of sample bridges[103] and completed for each bridge a standardized form that listed 90 or more bridge features to check for needed repairs. See 1 1979 Study App. at IV-2-8 to 13. The inspectors also took extensive photographs and conducted interviews with railroad personnel but Gunderson and his team relied

only on the information in the field forms. Gunderson (D) (May 14, 16, 1980) at 175-77, 578-79, El App. F at 29-31, 70-71.

The bridges in the sample were divided into three groups according to construction material: steel, masonry, and timber. The lengths of the bridges were added together to obtain the total number of bridge track feet (BTF) falling in each category. Relying on the information found in the field forms, Gunderson and his staff then placed each sample bridge into one of three possible repair classifications: no repair, light repair, or heavy repair. For example, Gunderson determined that, of the total BTF in steel bridges, 30 percent needed heavy repair, 65 percent needed light repair, and 5 percent needed no repair. 1979 Study at IV 25-27. To determine the bridge rehabilitation needs of each individual T, Gunderson took the total inventory of that T's BTF in each bridge category, and applied the repair percentages he had gleaned from the sample. Assuming EL had 1,000 BTF of steel bridges, 300 BTF would be deemed to need heavy repairs, 650 BTF to need light repairs, and 50 BTF to need no repairs. See generally 1979 Study at IV 20-27; 2 GP at E 57-87.

To transform these repair percentages into dollar amounts, Gunderson developed a work function for each bridge category and repair classification. The work function was simply a standardized repair cost for each classification. For example, Gunderson developed a standard cost per BTF for light repairs on steel bridges, a standard cost per BTF for heavy repairs on masonry bridges, and so on. The final step was to multiply the total BTF in each repair category by the applicable cost figure.

The fatal flaw in Gunderson's study is that the sample from which he drew his data lumped together bridges of all the Ts. Therefore, his data and conclusions reflect, if anything, the average condition of all the bridges conveyed by the Ts. For the purposes of deciding the rehabilitation needs of any individual T, however, the statistics are meaningless without proof that the bridges of all the Ts had fallen into the same state of disrepair. There is no credible evidence to support that assumption. A valid

study of this nature should have been based on separate samples for each T with separate repair percentages for each T. Indeed, this was the original approach adopted by the S&P team, but it had to be abandoned because of a scarcity of data for some of the Ts' lines. Gunderson (D) (May 19, 1980) Ex. 27, EL App. G at 203-4; *id.* at 672-76, EL App. F at 72-76; 3 GPRB at App. A 30-31.

In defense of his decision to lump all the Ts' bridges together rather than obtain repair percentages for each separately, Gunderson cited several reasons to support the assumption that the bridges of all the T's had fallen into the same state of disrepair. He pointed out that all the Ts were bankrupt, that the bridges were all subject to comparable climatic conditions, and that Ts all carried comparable commodities and loads on their lines. In addition, he stated that his impression that all the Ts' bridges were in comparable states of disrepair was partly based on conversations he had had at conventions with professional associates familiar with the Ts' maintenance practices. None of these justifications offer very firm ground for his assumption. That all the Ts were bankrupt offers only weak support for Gunderson's assumption, and even that support is undercut because the Ts went bankrupt at different times—some as early as 1967, others as late as 1972. If bankruptcy is indeed an indicator that maintenance is being deferred, then the length of time a railroad is in bankruptcy would indicate how long, and consequently how much, maintenance has been deferred. Gunderson himself admitted that, as to the EL, which went bankrupt in 1972, the fact of bankruptcy would not weigh very heavily as an indicator that EL's bridges were in the same state of disrepair as the other Ts' bridges. Gunderson (D) (May 21, 1980) at 1107-10, EL App. F at 187-90. The second and third reasons—comparable climatic conditions and comparable loads—may have something to do with the rate at which railroad bridges deteriorate with use, but have little to do with whether, and at what rate, a particular

railroad chooses to defer maintenance on its lines. Casual conversations at conventions could give one a reasonable basis for assuming that the Ts' bridges were falling into disrepair, but they are not a basis for concluding that all the Ts' bridges had fallen into the same state of disrepair.

Not only is there a paucity of support for Gunderson's assumption concerning the similarity in condition of the Ts' bridges, but the data in the Bechtel Study indicate that bridge conditions among the Ts differed substantially. For example, 93.4 percent of the CNJ steel bridges in the sample needed heavy repair, compared with only 7.1 percent of R's steel bridges; the repair percentages for the other Ts' steel bridges fell at various points between those two figures. Gunderson (D) (May 23, 1980) Ex. 76, EL App. G at 303. Similarly, wide disparities exist among the Ts in the repair percentages for masonry bridges. See Gunderson (D) (May 23, 1980) Ex. 76, EL App. G at 302. We must, of course, be careful to refrain from attaching too much importance to these figures for the individual Ts because the samples for each T are not large enough to give a reliable picture of bridge conditions throughout each T's system. Nevertheless, to the extent these figures provide at least some hard evidence of the comparative condition of the Ts' bridges, they undercut Gunderson's position.

The Ts assert that the S&P Study contained numerous other errors including the misinterpretation of Bechtel Study field forms, the failure to make use of other Bechtel Study data such as photographs and field interviews, and the use of inaccurate bridge inventories for some of the Ts. See generally 1 ELF 230-80; 2 RF at 384-434. Although some of the Ts' objections may have merit, particularly the criticism of Gunderson's interpretation of the data on the field forms,[104] we find it unnecessary to resolve these arguments. Because the GPs have not proved that the bridges of all the Ts were in the same state of disrepair, averages reflecting the condition of the bridges of all the Ts lumped together cannot yield reliable results when applied to the bridges

of each T individually. It would be pure happenstance if that sort of statistical technique yielded accurate results.

3. *Yards*

S&P's estimates for the RC of the Ts' yards are open to the same objection as are the bridge estimates: the data from which repair percentages were developed came from a sample that lumped the yards of all the Ts except PC together.[105] Again, this statistical technique rests on the unproved assumption that all the Ts' yards had fallen into the same state of disrepair. Moreover, the sample was not representative of the relative size of the various Ts. Of the 27 yards in the sample, only three were owned by EL, 1 ELF at 209; H. Morgan (D) (Apr. 23, 1980) Ex. 18, EL App. E at 73-75, even though EL was the largest T in the sample, proffering an average of over 2,000 miles of mainline track. See 1980 Study at VIII 5.[106] Finally, the S&P Study did not even approach the sampling frequencies specified by the Bechtel Study, nor was any consideration given to how large a sample had to be to give reliable results. See H. Morgan (D) (Apr. 23, 1980) at 1540, 1584-87, EL App. C at 205, 228-31.

The S&P yard study used other questionable statistical techniques, as illustrated by the following two examples. The study divided yards into three classifications—small, medium, and large. For the small yards, there were inspection results for only nine turnouts. Six of these were located in a single CNJ yard and all were deemed to need replacement. On the basis of those figures, the S&P Study concluded that 67 percent of all turnouts in all of the small yards owned by the Ts except PC needed to be replaced.[107] See H. Morgan (D) (Apr. 23, 1980) Ex. 18, EL App. E at 75; H. Morgan (D) (Apr. 23, 1980) at 1582-84, EL App. C at 226-28. Turnout RC estimates for large yards were not much sounder. Not a single EL or LV turnout was inspected. EL was nevertheless charged with RC (before salvage credit) for turnouts in its large yards ranging from $16.9 million to $26.5

million on its four proffers; LV was charged $7.4 million and $8.7 million on its two proffers. 1 ELF at 213; H. Morgan (D) (Aug. 20, 1980) Ex. 248, EL App. E at 258-64.

4. *The Government Parties' Defense*

In defense of the S&P Study, the GPs point to several studies and sets of statistics, developed by third parties, that purportedly confirm the accuracy of S&P's estimates. They cite the testimony of a PC witness, Clarence Jackman, who performed a RC and MOWE study on the PC lines. His figure for total RC and MOWE on the IFLs over an eleven-and-a-half-year period was about ten percent lower than S&P's figure. The GPs contend that the closeness of Jackman's results to their own confirms S&P's estimates for the other Ts.

EL has a convincing answer: the methodology used to determine PC's needs was not the same as that used for EL and LV. Morgan stated that he used track charts to aid in determining the condition of the Ts' lines. He admitted, however, that track charts were not used in his studies of EL and LV. H. Morgan (D) (Apr. 22, 1980) at 1366-69, EL App. C at 156-59. Similarly, although Morgan used 1976 and 1977 Conrail maintenance information in assessing PC, he had little such information for EL and none for LV. H. Morgan (D) (Apr. 22, 23, 28, 1980) 1369-73, 1465-66, 2063-64, EL App. C at 159-63, 187-88, 427-28. Nor did Morgan have any data regarding interim maintenance work ("section 215 maintenance")[108] done on EL and LV lines pending conveyance of properties to Conrail. He did, however, use such data for PC. H. Morgan (D) (Apr. 22, 1980) at 1369-70, EL App. C at 159-60. Although S&P's line speed and density assumptions were, as stated earlier, demonstrated to be too high in a number of instances relating to EL and LV, its PC data on these items was apparently more accurate, for PC did not challenge Morgan on this issue. ELRB at 56. As to bridges, PC bridges dominated the sample—almost 85 percent of steel bridges

and almost 70 percent of masonry bridges were on the IFLs and the Northeast Corridor lines. See Gunderson (D) (May 23, 1980) Ex. 76, 77, EL App. G at 302-03. It is likely therefore that the sample more nearly reflected the condition of PC's bridges than the condition of the other Ts' bridges. Finally, to assess PC's yard rehabilitation needs, the S&P team used a separate sample made up exclusively of PC yards. H. Morgan (D) (Apr. 16, 1980) Ex. 7, EL App. O at 73-75. In contrast, the sample used for the remaining Ts lumps together yards of all the Ts.

As this list of methodological differences shows, the S&P team used more complete data and more reliable samples in its study of PC than it used for its study of the other Ts at a number of stages. It is not surprising, therefore, that S&P's overall estimate for rehabilitating and maintaining the IFLs is only 10 percent higher than PC's own estimate. Had S&P used the same procedures for the rest of the Ts, there would be some force to the argument that Jackman's PC study validates S&P's methods, and therefore the reliability of S&P's estimates for the remaining Ts. Since S&P's methods were not the same for the rest of the Ts, however, the reliability of the PC estimates only serves to highlight the doubtfulness of S&P's estimates for the remaining Ts.

The GPs also cite statistics for actual rail replacement done by Conrail on the main IFLs between 1976 and 1979 as proof of the reasonableness of Morgan's rail replacement decisions. According to Morgan's testimony, Conrail replaced slightly more rail in those years than Morgan estimated would be required for the same period. H. Morgan (S) (Jan. 30, 1980) at 73-74. Again, because Morgan had considerable data concerning the PC lines that he did not have for the rest of the Ts' lines, his accuracy in predicting rail replacement on the IFLs does not prove the accuracy of his rail replacement estimates for the remaining Ts.

As a final argument in support of Morgan's rail replacement decisions, the GPs point to the results of a study conducted by AA on its Toledo-Ann Arbor line. The AA study estimated that about 18 miles of rail needed replacement, a figure almost the

same as Morgan's. See 1 GPRB at E 13 & n.50. This, the GPs argue, is further proof of the accuracy of Morgan's rail replacement estimates. This segment is so small in relation to the thousands of miles covered in the S&P study, see 1980 Study at VIII 5, and the difference between Morgan's figures and the figures of other independent studies on other lines is so large, that we cannot attach much significance to this single agreement between AA's study and Morgan's study.

Gunderson points to two independently performed studies as proof of the validity of his estimates. The first is a 1977 Conrail Study of the paint condition on its steel bridges. In Gunderson's expert opinion, paint condition is often a good indicator of the overall condition of a bridge. The results of the paint condition study, when reclassified into the repair categories Gunderson used in his own study (heavy repair, light repair, and no repair) were similar. The Conrail Study, like Gunderson's, is s system-wide study encompassing bridges conveyed by all the Ts. It therefore corroborates, if anything, only that Gunderson's system wide percentages are reasonably accurate. As to each T, however, it confirms nothing because neither Gunderson nor the Conrail Study used separate samples for each T.

The second study Gunderson cites for support is one performed by the engineering firm of DeLeuw-Novick concerning bridge RC on Northeast Corridor lines. DeLeuw-Novick's estimate for bridge RC on these lines was slightly larger than Gunderson's. This study confirms only the accuracy of Gunderson's estimates with respect to PC lines, an unsurprising result since his sample is dominated by PC bridges and is therefore likely to yield results representative of the condition of PC's bridges. Gunderson (D) (May 23, 1980) Ex. 76, 77, EL App. G at 302-03. Because there is no proof that the bridges of the other Ts were in the same condition as PC's bridges, DeLeuw-Novick's estimate proves nothing about the accuracy of Gunderson's estimates for the remaining Ts.

5. *Conclusion*

We reject as unreliable the figures generated by the S&P Study. The methods concerning three major items of rehabilitation—track, bridges, and yards—introduced uncorrectable errors into the results. Questionable sampling techniques, in two instances based on the unproved assumption that the rail facilities of all the Ts had fallen into the same state of disrepair, as well as a paucity of data, affect various parts of the Study. The incorrect interpretation of the AREA table and the misclassification of a number of the Ts' lines as to density and speed undermine Morgan's track RC estimates. There are large, inexplicable differences between S&P's results and the results of studies conducted by independent third parties. All these factors direct us to the conclusion that we cannot accept S&P's figures.

B. *Erie Lackawanna's Study*

The EL Study was done by Wyer, Dick & Co., a consulting firm, under the direction of the firm's Chairman and Chief Executive Officer, Charles Shannon.[109] Wyer Dick conducted the study in 1975 with the goal of determining the rehabilitation needed to restore EL's lines to efficient operation at their historical timetable speeds.[110]

Visual inspections of most of EL's track mileage provided the data for the Wyer Dick Study. The inspections were made by EL division engineers who prepared reports of needed rehabilitation work. Shannon (D) (May 25, 1979) Ex. 19, EL App. B at 36-93. Shannon and his team developed unit cost figures for doing the various kinds of work using EL's usual repair practices and production rates and 1975 material and labor costs. The estimate for EL's total system, including both proferred and unproffered lines, was $50 million. See Shannon (D) (May 25, 1979) 714-31, 742-43, EL App. B at 94-108, 148-49; *id.* Exs. 28, 31, EL App. B at 109-47, 155-56.

Shannon then made three adjustments to determine the RC for each of the four acquisitions proffered by EL. First, for each acquisition he excluded the cost of work assigned to lines not included in the acquisition. Second, to give a true picture of the condition of EL in 1973 (two years before his study), he made a deduction to account for the additional deterioration occurring in the intervening two years (the "shortfall" estimate). Finally, Shannon restated all costs in 1973 dollars.

As support for the validity of Shannon's estimate, EL offers the results of a study conducted independently by Chessie at about the same time Shannon did his study. See Preliminary Engineering Plan for Selected Property Acquisitions of Erie Lackawanna, Penn Central, Reading (Chessie Study), Shannon (D) (July 10, 1979) Ex. 36. EL App. B at 199-239. The Chessie Study estimated the cost of rehabilitating the portion of EL's system that Chessie surveyed at about $28.1 million in 1976 dollars. Shannon (D) (July 10, 1979) Ex. 36, EL App. B at 220. Shannon's estimate for essentially the same properties was $36.5 million in 1975 dollars.[111] In conducting their study, Chessie's engineers were aware of, and specifically rejected, significantly higher estimates prepared by DeLeuw, Cather as part of the Bechtel Study. Chessie Study at 14-15 EL App. B at 210-11.

The GPs open their attack on Shannon's estimates by pointing out that they did not include costs for rehabilitating bridges, yards, and signals. Although it is true that Shannon did not include those costs, they are accounted for elsewhere in the study. As to bridges and signals, Shannon determined that what deterioration had occurred would be rectified by the increase in expenditure he projected for routine annual maintenance.[112] Shannon (D) (July 9, 1979) at 983-84, EL App. B at 195-96. As to yards, Shannon concluded that, with the exception of two facilities, no substantial problems existed and that any needed work would be covered by the projected increases in routine maintenance. Shannon did make allowance in his rehabilitation budget for the two EL yards, Marion and Croxton, that he concluded

were in need of rehabilitation. Chessie's RC figures support the conclusion that the yards, signals, and bridges needed no substantial repairs. Chessie allotted only $815,200 for yards, $980,800 for signals, and $3,000,000 for bridges. In view of how low these estimates are, it is plausible that increases in routine maintenance would cure the minor deterioration that had occurred.

The GPs next argue that Shannon's estimates are too low because the study attempted to ascertain only the work necessary to meet minimum standards. They point to a directive issued by EL's chief maintenance of way engineer to the inspectors who gathered the data for Shannon's study. The inspectors were instructed to inspect only those lines not up to the 50 mph operating speed that was stated as the goal for EL's main lines. Shannon (D) (May 14, 1979) Ex. 15, 18 GP Supp. App. at 584. The GPs contend that this proves that the study was concerned not with making a complete evaluation of EL's system, but only with eliminating slow orders.

Shannon agreed in his deposition that a proper rehabilitation study requires a more detailed inspection than the inspection ordered by Chessie's chief maintenance of way engineer. Shannon (D) (May 24, 1979) at 671172, EL App. B at 150-51. He also testified, however, that he specifically countermanded that order. *Id.* Although he apparently did not countermand the instructions in writing, the reports filed by the inspectors show that they viewed most of EL's lines, not just those with slow orders. See EL App. B at 36-93; EL App. N pocket part. Moreover, even for those segments that were not inspected, significant track rehabilitation was ordered based on data obtained from maintenance records and the personal knowledge of EL's engineers. See ELRB at 69-70; EL App. N at 114-15.

The GPs also ask us not to attach any importance to the estimates developed by the Chessie Study, contending it was merely a preliminary report and that Chessie officials undoubtedly contemplated further evaluation of EL's rehabilitation needs. Although the Chessie Study was not as detailed as either EL's or

S&P's study, its methodology was reasonable. Chessie engineers obtained statistical data concerning the installation dates of EL's rail and nonrail facilities along with records of the maintenance performed on them, and confirmed this data by conducting visual inspections of portions of EL's lines. E. Johnson (D) (Mar. 16, 17, 1978) at 4-8, 42-44, EL App. B at 269-73, 32 GP Supp. App. at 306-308. Moreover, Chessie's senior assistant chief engineer in charge of the study testified that he and his team developed these figures with the idea that Chessie's financial planners would rely on the study in determining whether to purchase a portion of EL. E. Johnson (D) (Mar. 16, 1978) at 7-8, EL App. B at 272-73. Since our purpose is to determine how a potential acquirer would view EL's lines, the Chessie Study, on which Chessie was willing to rely in making its acquisition decision, is strong evidence of the reasonableness of EL's estimate.

The GPs argue that if the Chessie Study is used to confirm the EL Study, both Chessie's RC estimate and its annual MOWE estimate must be considered together. They point out that although Chessie's RC estimate is somewhat lower than EL's, the Chessie's annual MOWE figure is significantly higher. The GPs therefore suggest that a true picture of the Chessie Study results can be obtained only by adding together RC and ten years of annual MOWE. As calculated by the GPs, the total of RC and MOWE using Chessie's estimates yields a figure considerably higher than a comparable total using EL's estimates. In fact, the Chessie total falls about midway between the total using EL's estimates and the total using S&P's estimates. See 1 GPRB at E 26. The GPs would therefore have us conclude that the Chessie Study does not confirm EL's study any more than it confirms S&P's study.

As EL points out, the GPs have introduced no evidence that combining RC and MOWE in the manner they propose is a valid technique for comparing the results of Chessie's and EL's studies. In fact, EL's expert, Shannon, testified that such a comparison could not be made. Shannon (D) (July 10, 1979) at 1157-60,

EL App. N at 134-35, 18 GP App. at 358-359. No other witness gave contrary testimony. Shannon did agree with the GPs, however, that RC and annual MOWE are to some extent interchangeable, *id.*, and this proposition is supported by other testimony as well.[113] B. Murphy (D) (June 20, 1980) at 138-39, 2 LV App. at 262-63; see LV at 50. Indeed, both Shannon and Adik, LV's expert, implicitly rely on the notion of interchangeability in excluding certain items of repair—*e.g.*, bridges and signals—from their RC estimates. Their rationale for doing so, which we have accepted, is that they provided for those repairs by increasing their annual MOWE estimates. Shannon (D) (July 9, 1979) at 983-84, EL App. B at 193-94; Adik (S) (EL) (Dec. 31, 1978) at 14. Although RC and annual MOWE are perhaps not interchangeable dollar for dollar, we conclude that there is validity to the GPs' argument and that at least a rough comparison can be made along the lines they suggest.

Even though we agree with the GPs that the comparative technique they suggest is useful, the GPs have failed to convince us that the Chessie Study does not support EL's estimates. EL points out several flaws in the figures the GPs used to compute their 10-year totals.[114] After corrections for these errors are made, the total of combined RC and 10-year MOWE using Chessie's estimates moves considerably closer to the total using EL's estimates. As adjusted, the EL's 10-year total is 85 percent of Chessie's total.[115] In contrast, the S&P's total is 160 percent of Chessie's. The revised pro formas submitted by EL in response to our June 19, 1981 letter demonstrate how inconsequential the difference between Chessie's and EL's estimates actually is. EL substituted Chessie's RC and annual MOWE figures for its own in the financial statement relating to a Chessie acquisition of a combined EL-LV system. The difference in Annual Cash Flow on the Cash Flow Statement averaged less than $1 million per year. *Compare* Memorandum of the Erie Lackawanna Trustees in Response to the Court's Letter of June 19, 1981, (July 10, 1981) at second table following page 10, Sp. Ct. Rep. at N 36177,

with id. at fourth table following page 7, Sp. Ct. Rep. N 36172. We do not thing this difference is substantial enough to erode the corroboration the Chessie Study provides for EL's figures.

The GPs make two final arguments relating to two of the adjustments Shannon made to his raw RC figures. First, they contend that Shannon erred in his calculations concerning the restatement of his estimates from 1975 dollars into 1973 dollars. In deriving costs in his study Shannon used wage rates prevailing on January 1, 1975, and materials prices prevailing on March 31, 1975. To adjust his estimate to 1973 dollars, Shannon relied on indices calculated by the Association of American Railroads (AAR) that provide a basis for comparing year-end wage and materials costs for a given year with the year-end costs from previous years. Shannon used the indices comparing year-end 1975 figures with year-end 1973 figures. The GPs argue that since the wage and materials costs he used in his study were those prevailing at the beginning of 1975 rather than at the end of 1975, it would have been more accurate to compare 1974 year-end figures with 1973 year-end figures; *i.e.*, only a one-year adjustment was needed to restate Shannon's estimates in 1973 dollars.

EL has a ready, if not entirely convincing answer. See ELRB at 67 n.59. As to labor prices, they contend that wage rates generally become effective on January 1 of any given year, and that a two-year adjustment is therefore necessary to get from 1975 labor rates to 1973 labor rates. Similarly, as to materials prices, materials used in 1973 maintenance would have been purchased in early 1973 before work actually got under way, so a two-year adjustment back from March 1975 to March 1973 was also appropriate. We are uncomfortable with EL's explanation concerning the two 1 year adjustment to labor costs, largely because the choice between a one-year and a two-year adjustment hinges on the time of year that labor rates actually increase, and we can find no support for the assertion that labor rates generally go up on January 1.[116] Absent such support, the year-end 1974 index for labor appears more appropriate than the 1975 index.

There is some support for the argument concerning materials, however, because Shannon did testify that the normal maintenance season begins in March; Shannon (D) (May 24, 1979) at 658, 18 GP Supp. App. at 289. Most materials purchases, therefore, would be made in anticipation of the maintenance season. We conclude that as to labor costs only a one-year adjustment is proper, but that as to materials prices the two-year adjustment made by Shannon is correct.

Second, the GPs point to an inconsistency in the calculation of the shortfall adjustment. Shannon made shortfall adjustments to account for the years 1974 and 1975. The GPs note, however, that a legend on a summary sheet identifies the EL figures as an estimate of "catch-up maintenance . . . as of April 1, 1975". If that is correct, the GPs argue, no shortfall adjustment should have been made for 1975 because Shannon's figure did not reflect the effects of any further deterioration occurring in 1975. On the other hand, if Shannon's study actually reflected conditions as of the fall of 1975 when EL's lines were inspected, the shortfall for 1975 was incorrectly computed because it did not account for the effect of § 215 funds provided to EL for maintenance during 1975.[117] There is little doubt that Shannon's study stated conditions as they were in the fall of 1975. Shannon (D) (May 25, 1979) at 714-15, 717, 726-27, EL App. B at 94-95, 97, 106-07. EL does not contest that the shortfall adjustment is incorrect for the reasons stated by the GPs, ELRB at 67 n.59, so we conclude that the shortfall adjustment must be corrected to account for the § 215 funds spent by EL in 1975.

EL's RC estimates stand up under the GPs' attack. The GPs have pinpointed no serious error in Shannon's methodology. The Chessie estimate, prepared by an independent party with no motive to understate costs, corroborates the EL figures. We conclude that EL's figures, as adjusted to correct the two errors identified by the GPs, provide reasonable estimates of the rehabilitation needs of EL's lines.

Appendix H

C. *Lehigh Valley's Study*

LV's RC and MOWE estimates were compiled by Stephen Adik, a LV Vice President with experience in a number of phases of railroad operations including maintenance. Adik-2 (S) (LV) (Dec. 31, 1978) at 2-5. Adik authored two studies of LV, one to estimate the value of all LV lines conveyed to Conrail, another to determine the RC and MOWE of only those lines included in the EL-LV combined systems. He used different techniques to estimate RC in each study. Because we accept the EL-LV acquisition as the most likely outcome in the alternative scenario, we analyze only the study dealing with the LV lines in the EL-LV acquisition.[118]

Adik developed his RC estimate for those lines from information and work papers submitted to the ICC in the 1974 *Ex parte* 305 proceeding. In that proceeding, a number of railroads sought rate increases to provide funds for reducing deferred maintenance and for making capital improvements. To justify the increases the railroads presented their estimates of necessary rehabilitation. LV estimated that $28.1 million was required to rehabilitate its entire system. See LV at 78. Adik adjusted this figure to eliminate the costs attributable to unproffered lines and to restate the estimates in 1973 dollars. He also reduced the *Ex parte* 305 estimates to account for differences between the maintenance work practices of LV and the more efficient work practices of a potential acquirer.[119] Finally, Adik eliminated the costs attributable to bridges, tunnels, and signals because they were small enough to be absorbed in an expanded annual MOWE budget. After these adjustments, RC on LV lines in the EL-LV acquisitions totalled $7.8 million. Adik (S) (EL) (Dec. 31, 1978) at 13-15.

Adik based his annual MOWE estimates on a study conducted by Wyer Dick for USRA, which examined the maintenance costs of railroads similar to LV over a 17-year period. That study

produced unit cost figures for seven major types of track maintenance. USRA adjusted these figures 1973 cost levels and made several other slight modifications. These adjusted figures provided the basis for Adik's estimate for those seven major types of track maintenance, and he extrapolated from that estimate to obtain estimates for other types of maintenance not covered in the Wyer Dick study. Adik's estimate for annual maintenance came to $9.8 million per year. *Id.* at 10-13.

Before examining the GPs' major attack on Adik's study, we address two relatively minor contentions concerning adjustments Adik made to the *Ex parte* 305 submission. The GPs argue, first, that Adik should not have eliminated the costs of nontrack items from his study. Adik's reason for doing so was that the relatively minor deterioration in those items (he placed it at 1.2 years of deferred maintenance at LV's 1973 actual expenditure level, *id.* at 14) could be eliminated over several years by increased annual MOWE. In light of the small amount of deferred maintenance, about $1 million, and the size of Adik's annual MOWE estimate—his estimate is $2.5 million higher than S&P's—we find Adik's explanation reasonable.

The second contention has more merit. The GPs argue that there is no basis for Adik's adjustment to account for more efficient work practices of a potential acquirer. See Adik (S) (EL) (Dec. 31, 1978) Schedule 14 at 1. Adik admitted that he lacked familiarity with the work practices of the Western railroads named as possible acquirers, and that he had only limited knowledge of Norfolk & Western. The only proposed acquirer with which he had any significant familiarity was Chessie. Adik (D) (May 9, 1979) at 72-73, 8 GP Supp. App. at 519-20. The main basis for Adik's adjustment was his observation that USRA equipment and work practices under the § 215 program undertaken in 1975 were more efficient than LV's and that such "equipment and practices, in all likelihood, [were] similar to those already in use by most potential purchasers in 1973-74". Adik (S) (EL) (Dec. 31, 1978) at 14. Adik did, however, testify that

it would be impossible to predict exactly what work practices would apply after an acquisition, because that is a subject negotiated by labor and management. Adik (D) (May 9, 1979) at 76, 8 GP Supp. App. at 521. As we suggest below, however, see pp. 117-18, *infra*, labor would have been flexible in renegotiating inefficient work rules with the acquirers, and profitable railroads are likely to use equipment that approaches as nearly as possible the most efficient equipment available. Consequently, we believe that Adik's adjustment of $2.225 million was appropriate.

The GPs' major attack on Adik's RC estimate revolves around the testimony of Bryan Murphy. Murphy is now a planning engineer for Conrail, but as LV's Chief Engineer in 1974 he was in charge of the study that produced the *Ex parte* 305 submission on which Adik based his estimate. Murphy testified that the *Ex parte* 305 estimate reflected the minimum amount of rehabilitation necessary; that it reflected a "short term 'patchwork' approach to rehabilitation". B. Murphy (S) (Jan. 30, 1980) at 10. As such, he urged, the *Ex parte* 305 submission understates the true rehabilitation needs of LV.[120]

Because of his position as Chief Engineer of LV, Murphy's testimony cannot be taken lightly. Nevertheless, we have reservations about it. The *Ex parte* 305 submission was made in the latter part of 1974. In April of that year, Murphy had produced an estimate for track rehabilitation that placed the cost of rehabilitating track in the entire LV system at $6.5 million. His first *Ex parte* 305 estimate placed track rehabilitation needs at $18.6 million, nearly three times as much as he had estimated only a few months earlier. His estimate for total RC including both track and nontrack items was $24 million. The President of LV, who was well acquainted with the railroad's condition, felt that even this estimate was too low, and asked Murphy to review and resubmit his report. Murphy's final figure, $28.1 million, is the figure Adik relied on in making his estimate. The sequence of events leading to that estimate indicates that Murphy is susceptible to suggestion and casts doubt on Murphy's assertion that the *Ex*

parte 305 estimate was merely a minimum figure. Moreover, LV had no motive to understate that figure; it was trying to justify a rate increase. If anything, LV had a motive to overstate its rehabilitation needs. In short, we are not convinced that the *Ex parte* 305 estimate is as conservative as Murphy says it is.

Fortunately, we need not resolve the issues whether and how much the *Ex parte* 305 submission understates LV's rehabilitation needs, because the overall results of Adik's study do not differ markedly from S&P's results. Although Adik's RC estimate is substantially lower than S&P's, his annual MOWE estimate is substantially higher.[121] Accepting that RC and annual MOWE are to some extent interchangeable and using the rough method of comparison suggested by the GPs in their argument concerning EL, the two studies yield results only seven percent apart. Using S&P's figures, the total of combined RC and ten-year MOWE is $113.36 million; with LV's figures the total is $105.44 million. See H. Morgan Corrections (S) (June 6, 1980) Tables VIII-2aA, VIII-2bA; Adik (S) (EL) (Dec. 31, 1978) Schedules 11, 14 at 1. Given the demonstrated unreliability of the S&P Study, and the tendency of that study to overstate RC, we have no reluctance in accepting Adik's slightly lower figures. Even with Adik's figures, the RC per track mile assessed against LV is substantially higher than the cost assessed against either EL or R.[122]

D. *Ann Arbor*

AA takes an approach different from EL and LV. AA maintains that its Toledo-Ann Arbor line would have needed no rehabilitation at all because its acquirer would have chosen to reduce the operating speed on the segment from 40 mph to 25 mph. To support this contention, AA offered the testimony of two witnesses—Michael Weisman, a financial officer for D,T&I which operated AA before adoption of the FSP, and Warren Hale, a consulting engineer with Thomas K. Dyer, Inc. Weisman stated

that from his vantage point as a cost expert it would not make any sense to maintain the 40-mile stretch in conditions above that necessary to operate at 25 mph. Weisman (D) (June 28, 1979) at 29, 3 AA Supp. App. at 190. Hale corroborated that testimony by stating that because of the small size of the line and the light density of traffic running over it, the Toledo-Ann Arbor segment could be operated at 25 mph with little or no adverse impact on rail operations. Hale (S) (Oct. 15, 1980) at 8.

The GPs attack this evidence as insufficient to prove that an acquirer would have reduced the line's operating speed. They contend that Weisman was not qualified to offer this sort of testimony because there was no showing that he had any expertise in railroad engineering, maintenance, or operations, areas the GPs contend are essential to the making of such a prediction. 3 GP at K 43-44. We disagree. As an expert in the financial aspects of railroad operations, Weisman is well suited to make judgments concerning the impact a reduction in speed would have on profitability; he need not have maintenance experience to determine that a line can operate as profitably at 25 mph as at 40 mph. Moreover, the testimony of Hale provides a corroborating view from a railroad maintenance engineer whose railroading credentials the GPs acknowledge. See 1 GPRB at E 55. Finally, the GPs have offered no evidence to rebut this contention. Although AA's evidence on this point could have been stronger, we deem it sufficient to establish that AA would have been operated at 25 mph.

We cannot, however, accept AA's argument that no rehabilitation would be needed if the operating speed were dropped to 25 mph. AA offered no credible testimony to support that view. AA's witness Hale stated that some rail replacement would still be necessary on AA's line at the reduced speed, although not nearly as much as Morgan predicted. Hale (S) (Oct. 15, 1980) at 8. The single piece of evidence AA cites is a letter from AA's trustee to the FRA listing slow orders on AA. There were but two slow orders calling for speeds below 25 mph in existence in

March 1975, and only one of the two was caused by track deterioration. AA argues that this absence of slow orders proves that no rehabilitation is needed to operate the line at 25 mph. However, the absence of slow orders does not mean that the line is not on the verge of requiring slow orders.

Other evidence submitted by both AA and the GPs suggests that at least some rehabilitation would have been needed even at a lower operating speed. Operating speed has a direct impact on the rehabilitation standards applied to track, but, as the GPs point out, it does not affect those standards relating to bridges, yards, and signals. 3 GPRB at App. A 82-83 & n.171. See generally 1980 Study at IV 18-34. Indeed, Morgan testified for the GPs that reducing the speed would not require a reduction to the original S&P estimate of even 50 percent. H. Morgan (D) (Aug. 19, 1980) at 4574, 28 GP Supp. App. at 346. And as to track rehabilitation, where a reduction in speed would have its greatest impact in reducing rehabilitation, even AA's witness Hale would not go so far as to say that lowering the speed would eliminate all rail replacement. Both Hale and Morgan had originally called for about 18 miles of rail replacement if the operating speed remained at its historical level. See 1 GPRB at E 13. Hale stated that two of these miles would still require replacement at a 25 mph operating speed. Hale (S) (Oct. 15, 1980) at 8-9. And as the GPs point out, the remaining 16 miles not replaced would probably still require some less drastic forms of rehabilitation work.[123]

We conclude that some rehabilitation would be required even if the line's operating speed were dropped to 25 mph. Our problem is to determine how much would have been needed. At the outset, we reject Morgan's statement that, at most, reducing AA's operating speed would have cut his estimate of RC in half. We have already detailed the problems in his initial estimate; adjusting a flawed initial estimate for speed variations would yield only a flawed result. Furthermore, a reading of the transcript of the deposition at which Morgan offered this judgment

reveals that Morgan had no opportunity to consider seriously the effect of a reduction in speed.[124] Indeed, the GPs do not rely on Morgan's remark. See 3 GPRB at A 82.

The only considered evidence on this point is Hale's rebuttal testimony. As noted earlier, Hale stated that the rail on two miles of track would have to be replaced in order to rehabilitate AA to 25 mph operating speed. At his deposition, Hale also stated that no surfacing beyond what would be provided for in normal maintenance would be required. Hale (D) (Feb. 12, 1981) at 130-31, 1 AA Supp. App. at 155-56. The GPs challenge Hale's assessment of AA's track rehabilitation needs because he relied on only two sources in making his judgments—track charts (showing the weight and date of installation of rail) and Sperry Defect Reports (annual reports of rail failures due to rail defects). 3 GPRB App. A 84. The GP's mischaracterize Hale's testimony, however. While these may have been the only written sources he used, Hale also testified that he relied on the knowledge he gained in preparing his original testimony. Hale (D) (Apr. 11, 1979) at 16, 25 GP Supp. App. at 471. Furthermore, the GPs have presented no evidence showing that Hale's reliance on these two sources was improper. Given that Hale was limiting himself to a relatively small length of track of which he had detailed knowledge and that the GPs admit that he is an expert in this area, see 1 GPRB at E 14, we see no reason why his judgment on rail replacement cannot be trusted.

Hale made no attempt in his rebuttal testimony to estimate AA's yard, tie, signal, turnout, or bridge rehabilitation needs assuming a reduced operating speed. The only other evidence on AA's rehabilitation needs is Hale's original study. The GPs correctly identified a problem with relying on this testimony, however. Although most witnesses defined RC as the amount of work necessary to bring the Ts' lines up to good operating condition or the condition "at which the asset should be maintained if operations are to be continue [sic] over an indefinite period of time", Hale (D) (May 16, 1979) at 4, 11 GP Supp. App. at 783;

see note 110, *supra,* Hale's study was designed to determine what expenditures would be necessary to keep AA running for three to five years. Hale (D) (May 16, 1979) at 3-4, 11 GP Supp. App. at 783-84. But while Hale may have understated the AA's rehabilitation needs in this respect, he clearly overstated them in another. Hale testified that, under the federal classification scheme, to operate AA at 45 mph, as he assumed, it would have to be maintained at the level of a 60 mph railroad. Thus Hale was applying much more stringent standards for track rehabilitation than he would have done had he assumed a 40 mph operating speed, as did Morgan and Gunderson. We suspect that Hale's use of excessively stringent standards offset his short-term perspective. Our impression is reinforced when we observe that Hale and Morgan reached strikingly similar results in determining the amount of track replacement necessary.[125] Our reasoning applies equally to all components of rehabilitation affected by operating speed, including mainline ties and turnouts. Since we have no basis for adjusting these numbers to reflect a 25 mph operating speed and since AA has the ultimate burden of proof on this point, we charge AA with the entire cost of these items as estimate by Hale.

Several components of RC, however, are not affected by main line operating speed. For rehabilitation of these facilities—yards, signals, and bridges—we have more difficulty in accepting Hale's estimates because no countervailing error offset the short-term perspective of Hale's study.

On bridges, however, neither can we adopt the GP's estimate. The S&P study concluded that RC for AA's bridges would amount to $480,000. H. Morgan Corrections (S) (June 6, 1980) at Table VII-12aA. But, as AA points out, the S&P sample included only five AA bridges. AA at 162; Gunderson (D) (July 21, 1980) Ex. 146. Of the five AA bridges considered, *none* required anything more than light repair. See AA at 162. Thus, what little evidence the GPs adduced on AA's bridges tends

to support Hale's conclusion that there is no need for rehabilitation work, and that is the conclusion we accept.

With regard to signals and yards, we are confronted with a problem that does not lend itself to a similar resolution. S&P estimated that RC for signals would be $10,000 and that yard rehabilitation would cost of $1,040,000. Hale, on the other hand, does not seem to have offered any figure for rehabilitation of signals, and concluded that yard rehabilitation could be accomplished for $45,000. We know of no way to adjust Hale's figure explicitly to correct for his short-term perspective or to adjust S&P's figure to account for the errors discussed earlier, and we doubt that any potential acquirer would have been able to make such adjustments. A potential acquirer confronted with these figures would have weighed the shortcomings of both estimates and arrived at an educated guess. On yards and signals, then, we find that a potential acquirer would have expected to incur costs of $250,000 in rehabilitation.

The only factor left to be determined is how long the rehabilitation program would have taken to complete. Morgan and Gunderson projected that it would take two years—Hale said only that it would take "several". See Hale (S) (Oct. 15, 1980) at 7-8. Since we do not know how long "several" years is, we accept the GP's evidence on this point.

The following table reflects the rehabilitation costs which we believe an acquirer of AA's lines would have expected to incur:

Item	Amount	Unit Cost	Item Cost
Main line rail	2 miles	$75,000	$150,000
Main line ties[126]	6,288	20	125,760
	400	25	10,000
Turnouts	8	7,500	60,000
Surfacing	NA	NA	0
Bridges	NA	NA	0
Yards and Signals	NA	NA	250,000
Total			$595,760

Appendix H

E. *Annual Maintenance of Way Expenses*

None of the parties devoted a great deal of attention to annual MOWE in their briefs, choosing instead to focus on rehabilitation. Accordingly, most of the Ts can be dealt with briefly. As demonstrated above, LV's MOWE figure is higher than that of S&P and that fact was important in our decision to accept LV's rehabilitation estimate. We do not expect that the GPs will object to our acceptance of LV's MOWE estimate as well. As for AA, the GPs put annual MOWE at $609,000 while AA's witness estimates it at $450,000. H. Morgan Corrections (S) (June 6, 1980) at Table VIII-2bA; Laurie (S) (AA) (Dec. 31, 1978) Ex. 1 at Table 4. Since Laurie was the only witness who based his estimate on the assumption of a 25 mph operating speed, see *id.* at 6, and since the GPs offer no reason why that estimate understates true MOWE, we accept Laurie's figure. This leaves us with EL.

As experts for both EL and the GPs have testified, RC and annual MOWE are to at least some extent interchangeable; one engineer may treat a particular repair item as rehabilitation, another may treat it as MOWE.[127] Any attempt to combine EL's RC estimates with S&P's MOWE estimates therefore incurs the risk of excluding some items of repair and duplicating others. We nevertheless deem it necessary to examine S&P's MOWE estimates to determine whether there is some good reason to substitute them for those of EL. We find none.

To determine MOWE, S&P developed maintenance cycles for each type of rail facility. Each cycle described the amount of annual maintenance needed for a particular facility based on its expected life and maintenance needs. For example, S&P estimated that new 140-pound rail in use on lines with densities of 20-30 MGT needs replacement at a rate of 3.57% per year. 1980 Study at IV 13. How much maintenance each T needed of course depended on the size of its inventories of the various facilities studied. S&P also developed maintenance work functions,

similar to the rehabilitation work functions, to provide unit costs for various kinds of maintenance work. Applying these unit costs to the maintenance needs defined for each T produced annual MOWE estimates.

Comparing EL's MOWE figures with S&P's is difficult because EL did not separately calculate MOWE. Those expenses are accounted for as reductions to net operating income in EL's pro forma statements. According to its own calculations, EL estimates that its MOWE figure for the EL-LV Western Line acquisition is about $9 million lower than S&P's. EL contends that this difference can be explained by a number of errors in S&P's methods that tended to overstate MOWE. At least some of EL's contentions have merit.

EL points first to inaccuracies in S&P's data concerning the amount of track mileage in the EL proffers. The primary error concerns Morgan's overstatement of yard track miles. He used a Conrail system-wide ratio of yard track to main track mileage to estimate the yard track mileage in EL's proffers. Ratios specific to EL were readily available, and EL contends that Morgan should have used them instead of Conrail's system-wide ratios. 1 ELF at 218. The GPs argue that there is no record support for that assertion. 3 GPRB at App. A 194. Common sense, however, indicates that a ratio specific to EL would give a more reliable estimate of EL's yard track mileage than would Conrail's system-wide ratio, which of course covers lines of all Ts. To the extent that the use of the Conrail's ratio overstated EL's yard track mileage, S&P overstated yard maintenance.[128]

El also contends that in developing his MOWE figures, Morgan failed to take into account the effect of his rehabilitation program, resulting in a duplication of rail replacement. For example, Morgan replaced 1,070 miles (40%) of the 2,650 miles in the Western acquisition. See H. Morgan (D) (Aug. 14, 1980) Ex. 185, EL App. E at 238. According to the table in the 1980 Study at IV 13, the replacement rail had a useful life of at least 40 years.[129] Morgan did not exclude or otherwise adjust for this

substantial amount of new rail on EL's lines in estimating annual rail replacement. He projected 56 miles of rail replacement per year, which, over a period of 40 years, amounts to 2,240 miles. See H. Morgan (D) (Aug. 20, 1980) Ex. 247, EL App. E at 256. At that rate of rail replacement, Morgan would replace over 600 miles of rail in EL's lines more than once within a 40-year period.

We do not accept EL's argument that the replacement of more than all of the rail over the 40-year period proves that Morgan's MOWE estimates were excessive. On the contrary, Morgan assumed that the replacement that was part of the rehabilitation program had already occurred when he stated that relaying 2.5 percent of the rail each year would maintain the track in average condition. H. Morgan (D) (May 5, 1980) at 2608-20; EL App. D at 77-89; 3 GPRB at App. A 208-10. Thus, over 40 years beginning from the time rehabilitation was completed, Morgan's maintenance program would replace one hundred percent of the rail, which is exactly the result EL seems to be urging. Yet we do think Morgan's figures are inaccurate to an unquantifiable extent for a reason suggested at his deposition. Although it is reasonable to assume that all the rail would require replacement over a 40-year period, we see no reason to assume that the need for replacement would occur evenly over the 40 years. Indeed, given that 40 percent of the rail would have been newly laid during the rehabilitation years, it is probable that the need for replacement would arise disproportionately in the final years of the 40-year period. The present discounted value of a stream of payments made regularly at constant levels would differ substantially from the present value of a stream of initially small payments followed by larger payments, even though the sum of payments in the two streams was the same. See note 54, *supra*. Morgan testified that he was unfamiliar with discounted value and did not consider it. See H. Morgan (D) (May 6, 1980) at 2879-80, EL App. D at 244-45.

EL also makes several convincing arguments concerning Morgan's overstatement of labor costs in certain maintenance work

functions. Morgan assumed that productivity in yard maintenance work would be very low; only 40 to 60 percent of work time in yards was considered productive. See 1980 Study at V 1-5. This view is contradicted by the Bechtel Manual, which states that full productivity should be assumed in yards except for weather delays. See Morgan (D) (May 7, 1980) Ex. 105, EL App. E at 186. The large difference in figures suggests that Morgan understated yard work productivity. Morgan also overstated labor costs in some work functions by double counting the labor costs attributable to field mechanics, by including the labor costs of signal maintainers in yard maintenance functions even though yards generally do not have signals, by calculating twice as many man hours as necessary for distributing materials for rail replacement, and by overstating the costs of ballast cleaning. 1 ELF at 295-99. Neither Morgan nor the GPs contest these errors.

The GPs effectively rebut most of the other errors asserted by EL. On the whole, S&P's MOWE estimates stand up better than its RC estimates, and that perhaps explains why the Ts' estimates and S&P's estimates are reasonably close to each other. EL has nevertheless convinced us that S&P overstated EL's MOWE costs to some unquantifiable extent. The GPs, on the other hand, have not separately attacked EL's MOWE figures or the methods used to estimate them. In these circumstances, we conclude that, having accepted EL's RC figure, we should accept its MOWE estimates as well.

F. *Conclusion*

The efforts of the Ts, and particularly EL, have exposed a number of errors in the S&P Study sponsored by the GPs. The methods and data employed in several parts of the study were either incorrect or so questionable as to negate any reliability of the estimates it produced. We are convinced that the S&P Study has overstated, to a substantial though unquantifiable degree, the

rehabilitation needs of the Ts. Although S&P's MOWE estimates do not suffer the same shortcomings as its RC estimates, we are also convinced that, at least with respect to EL, S&P's MOWE estimated is too high.

The GPs have similarly exposed errors in the estimates presented by the Ts. Unlike the errors in S&P's study, however, those in the studies relied on by two of the Ts—EL and LV—do not undermine the reliability of the studies as a whole. Furthermore, the errors are all quantifiable and can be corrected by relatively simple recalculations. We therefore decide that the RC and MOWE figures submitted by EL and LV, as corrected to account for the errors detailed in our discussion of those Ts' studies, provide reasonably accurate estimates of the costs that would have faced an acquirer of those lines. As to AA, neither side has provided us with an overall estimate of RC which we can credit. Nonetheless, we believe that the evidence is sufficient to allow us to determine what AA's rehabilitation needs would have been assuming a drop in operating speed. We do fully accept the AA's estimate of MOWE.

IX. Labor Protection Costs

A. *Introduction*

There has been a long history of collective bargaining agreements, federal statutes, and ICC orders that have provided labor protection for railway workers by guaranteeing employment and compensatory financial assistance to workers adversely affected by various types of organizational changes in the railroad industry. An excellent discussion of the history of such labor protection has been provided by Judge Waterman in *New York Dock Ry.* v. *United States*, 609 F.2d 83, 86-90 (2 Cir. 1979), and there is no need to repeat it here.

The GPs argue that the cost of labor protection either would have been borne directly by the Ts—and therefore must be offset against the proceeds of rail use sales—or would have been

assumed by the acquirers—thus reducing sales prices directly. 5 GP at S 1-3. The Ts do not contest this. Rather, they contend that the proffered transactions would have resulted in either minimal or no labor protection costs. ELRB at 254-55; LV at 98. The Ts' responses raise two principal issues—(1) the level of labor protection benefits that would have applied in the proffered transactions; and (2) the costs of this level of benefits—which are addressed in the following sections.

At the outset we note that labor protection costs would have been a factor only in the case of rail use sales and, as later explained, see pp. 116 & n.142, *infra*, even in those only to the extent that the excess of sales price over scrap value would have been greater than the labor protection costs. The GPs do not contend that existing labor protection agreements would have been applicable in the event the Ts abandoned their lines and sold them for scrap, and as our discussion of these agreements below suggests, we would reject such an argument. See pp. 104-10, *infra*. Similarly, the GPs appear to concede that the ICC would not impose labor protection responsibilities on the Ts in the context of complete abandonment of the T's lines for scrap. 5 GP at S 147. In any event, the ICC's decisions under sections 1(18) and 5(2) of the Interstate Commerce Act, 49 U.S.C. §§ 10901, 11701, strongly suggest that no labor protection payments would have been required if a T had abandoned all its lines.[130] Moreover, we would have considerable doubt regarding the constitutionality of ICC imposition of labor protection conditions in the abandonment of a hopelessly losing railroad.[131]

B. *Level of Labor Protection*

1. *Existing Agreements*

Discussion of the level of labor protection that would have accompanied the proffered transactions must begin with an examination of the agreements and statutes bearing on the subject. These would have been of obvious importance in litigation

and would have been an important consideration in negotiations between labor and the Ts. Although the GPs contend that a number of existing labor protection agreements would have been applicable to the proffered transactions,[132] their arguments with respect to the Ts remaining in the case focus almost exclusively on two such agreements—the Washington Job Protection Agreement (WJPA) and the Erie Lackawanna Merger Protection Agreement (ELMPA).

The WJPA, entered into in 1936 by representatives of most rail carriers and railway unions, is binding on all remaining Ts either by succession or adoption, and provides protections for all employees represented by labor organizations party to the agreement. Ex. GPS—Labor 10. The agreement guarantees protected employees a choice between a monthly dismissal allowance of up to 60 percent of a base salary for a maximum of five years following dismissal or a lump-sum separation payment. Both types of benefits vary with the length of an employee's service with the railroad.

The Ts contend that the WJPA would not have been applied in the circumstances of the proffered transactions. 2 ELF at 540-51; LV at 110-14. The WJPA is applicable to employees adversely affected by a "coordination", defined as:

> joint action by two or more carriers whereby they unify, consolidate, merge, or pool in whole or in part their separate railroad facilities or any of the operations or services previously performed by them through such facilities.

WJPA § 2(a). The agreement also provides that:

> the provisions of this agreement are to be restricted to those changes in employment in the Railway Industry solely due to or resulting from . . . coordination[s].

Id.§ 1.

The Ts argue that the proffered transactions would have fallen outside the WJPA's definition of "coordination". They reason that, by completely liquidating its properties and ending its corporate existence, a T would have escaped the WJPA's requirements of "joint action" that "unif[ies], consolidate[s], merge[s], or pool[s]" the properties of two or more carriers. Rather, they argue, the proffered transactions constitute unilateral liquidations, not involving the "joint action" of another carrier. The GPs respond that, insofar as the Ts' lines are to continue in rail use, the proffered transactions are indistinguishable from ordinary mergers, which typically involve the expiration of one party. 2 GPRB at S 110-11 & n.273.

We find the terms "coordination", "joint action", and "unify, consolidate, merge, or pool" ambiguous and unilluminating. The parties have produced little evidence bearing on the meaning of these terms and neither they nor we have found precedent relevant to the question.[183] A literal reading of the language of the WJPA would provide some support for the GP's claim that the agreement would have been applicable in the circumstances of the alternative scenario. We would be reluctant, however, to rest our holding on such a mechanical process of interpretation. The Ts' liquidation present situations unlike the typical merger with which the WJPA is principally concerned. See, *e.g.*, Ables, The History of and Experience Under Railroad Employee Protection Plans 136-37; Ex. GPS—Labor 45. Most notably, ordinary mergers are seldom marked by the characteristics of involuntariness and economic hardship that distinguish liquidations. The important differences between the circumstances of the alternative scenario and those of the subjects ordinarily considered within the scope of the WJPA would make us reluctant to read the ambiguous language of that agreement as applying to the proffered transactions.

However, we need not resolve the question of the proper interpretation of the WJPA. The difficult questions of legal interpretation raised by the WJPA would have confronted both the Ts

and labor's representatives had the proffered transactions actually occurred. Because of the uncertainty—described above —created by these questions, the parties would have harbored little confidence that their interpretation of the agreement would have prevailed in arbitration. We reject the conclusory opinions of the GP's witnesses, *e.g.*, Lowry (S) (Jan. 31, 1979) at 37-39; Mahoney (S) (Jan. 31, 1979) at 43-50, that labor organizations would have insisted on arbitration of disputes regarding the WJPA. These opinions were premised on the notion that the WJPA provided clear support of labor's claims, a contention that we reject.[134] We find that the uncertainty that would have surrounded the question of the agreement's applicability in the context of the proffered transactions would have made both the Ts' and labor's representatives reluctant to seek arbitration of the issue. Neither party would have had any confidence regarding the ultimate outcome of arbitration, and an adverse, binding decision would have seriously weakened the loser's bargaining position. We conclude, therefore, that the parties would have proffered the known hazards of negotiation to the perceived risks of pursuing arbitration to its conclusion. And, as discussed below, we conclude that negotiations would ultimately have produced new labor protection agreements acceptable to all parties.

We reach a similar conclusion with respect to the ELMPA, an agreement entered into by EL prior to its inclusion in the Norfolk & Western system in 1968.[135] The agreement incorporated Norfolk & Western's "Nickel Plate Agreement" and guaranteed both "attrition protection"[136] and the protections of the WJPA to all workers employed by EL as of April 1, 1968. Exs. GPS — Labor 30, 32. The ELMPA provided protection for any covered EL employee "deprived of employment or placed in a worse position with respect to compensation, rules, working conditions, fringe benefits, or rights and privileges pertaining thereto at any time during such employment." ELMPA, at App. A § 1(b), EL App. M at 94.

EL argues that the ELMPA would have been held inapplicable to the proffered transactions by an arbitration panel, 2 ELF at 527-34, reasoning that the ELMPA was impliedly conditioned on EL's continuation as an operating line. The GPs, in response, contend that "the agreement expressly contemplated the contingency that Erie would be unable to provide work for protected employees at some time in the future and required payment of benefits in *all* such circumstances." 2 GPRB at S 106.

It is far from clear to us that the ELMPA would have been applicable in the circumstances of the alternative scenario. The agreement was reached in the context of EL's inclusion in the Norfolk & Western system, and we would not lightly extend its sweeping protections to the quite different circumstances of EL's complete liquidation. Our view seems to be shared by the ICC which discussed the scope of the ELMPA's applicability in *Norfolk & Western Ry. and New York, Chicago & St. Louis R.R.—Merger*, 347 I.C.C. 506 (1974), *aff'd sub nom. Patton* v. *United States*, No. C-74-841 (N.D. Ohio 1975). EL sought suspension of its labor protection obligations during the course of its reorganization proceedings on the theory that the ELMPA was impliedly conditioned on EL remaining under Norfolk & Western's control—which ceased on EL's entering reorganization. Although the ICC rejected EL's contention, we think its reasoning indicated an appreciation of the limits on the ELMPA's applicability. The Commission stated that only when an employee was adversely affected as a result of "facility coordinations or other operational changes" that took place "pursuant to the inclusion of the E-L in the N&W system" was the ELMPA applicable. *Id.* at 513. In the *Norfolk & Western* case, which involved employees adversely affected by transfers and other changes in operating procedures occurring shortly after EL's inclusion in the Norfolk & Western system, this two-pronged test was clearly satisfied. *Id.*

In the circumstances of the alternative scenario there would have been considerable doubt as to whether the ICC's *Norfolk &*

Western standard was met. EL's employees would have been suffering adverse effects nearly a decade after inclusion in the Norfolk & Western system and for reasons unrelated to that inclusion. Moreover, EL's total liquidation and withdrawal from the railroad business bears little resemblance to the small-scale, internal operating changes that the Commission described in *Norfolk & Western.* In short, the terms "facility coordination[ ]" and "operational change[ ]"—particularly when viewed in the context of the *Norfolk & Western* case—cannot readily be applied to the quite different circumstances of the alternative scenario. We conclude that these considerations would have created very substantial doubts as to the applicability of the ELMPA in the proffered transactions.

This uncertainty surrounding the ELMPA would have been heightened by other questions regarding its applicability. EL finds support for its position in the words "during such employment" in the language of the ELMPA quoted above. EL asserts, not implausibly, that "such employment" presupposes its continued existence as an employer, a position that provides textual support for the two-pronged standard articulated by the ICC in *Norfolk & Western.*

Moreover, even if the ELMPA were deemed applicable in the circumstances of the alternative scenario, there would be a very real possibility that the agreement would have been altered by the ICC. In *Norfolk & Western* the Commission stated that it would suspend the requirement of attrition protection upon a "showing of substantial detriment to the public interest." *Id.* at 514. The Commission noted that its prior approval of the ELMPA's attrition protection provisions had been grounded on the fact that these provisions would not "impose a significant burden on any of the carriers involved". *Id.* at 514 n.3. In the circumstances of the alternative scenario, where EL was in a hopeless financial condition and its liability under the ELMPA might have reached $154 million, Kasher (S) (Nov. 1, 1979) at 43, the ICC could

easily have concluded that attrition protection was not only "significant", but so onerous as to require suspension of the agreement. This would have been particularly true if labor's insistence on attrition protection appeared likely to threaten the consummation of the rail use sales.

Although we find EL's arguments that the ELMPA would have been inapplicable to the proffered transactions persuasive, we are convinced that neither EL nor labor would have pursued arbitration to its conclusion. EL would have had little incentive to risk an adverse—and costly—decision from an arbitration panel, even though it likely would have regarded its legal position as relatively secure. Labor also would have been reluctant to seek arbitration, principally because it would have perceived the slight prospects it would have had of prevailing.

2. *Action of the Reorganization Courts*

Our conclusions regarding the uncertainty that would have surrounded the applicability of both the WJPA and the ELMPA are supported by the possibility that, even if these agreements were held applicable to the proffered transactions, they could have been rejected in the Ts' reorganization plans. ELRB at 531-34. The Ts rely on § 77(b)(5) of the old Bankruptcy Act, which provided that a plan of reorganization "may reject contracts of the debtor which are executory in whole or in part". The GPs respond that § 77(n) of the Bankruptcy Act, which provided that "[n]o judge or trustee acting under this title shall change the wages or working conditions of railroad employees except in the manner prescribed in the Railway Labor Act", would have prevented the rejection of any of the existing labor protection agreements. 5 GP at S 95.

Resolution of the evident conflict between these two provisions of the Bankruptcy Act would have been a difficult task. Although we do not address the question in detail, we do note a claimed disagreement on the issue between a respected authority

and the House Report accompanying the Bankruptcy Code. The Ts refer us to a leading bankruptcy treatise's discussion of a provision of the new Bankruptcy Code, 11 U.S.C. § 1167 (Supp. III 1979), which adopts substantially unchanged the provisions of § 77(n):

> It should be noted that section 1166 [sic] does not preclude rejection of a collective bargaining agreement under section 365 [granting the general power to reject executory contracts] or under a plan. Rejection of a collective bargaining agreement terminates the employer-employee relationship and is not within the proscription of section 1167 which merely prohibits a change in wages or working conditions.

5 Collier on Bankruptcy § 1167.01 (15th ed. 1980).

The GPs contend that the unsupported statement in Collier is inconsistent with the language of § 1167, which provides:

> *Notwithstanding section 365* of this title [providing for the rejection of executory contracts] neither the court nor the trustee may change the wages or working conditions of employees of the debtor established by a collective bargaining agreement that is subject to the Railway Labor Act.

11 U.S.C. § 1167 (Supp. III 1979) (emphasis added). Moreover, the House Report accompanying the Bankruptcy Code stated:

> Section 1167 is derived from present section 77(n). It provides that notwithstanding the general section governing the rejection of executory contracts (section 365), neither the court nor the trustee may change the wages or working conditions of the debtor established by a collective bargaining agreement that is subject to the Railway Labor Act, except in accordance with section 6 of that

> Act. The subject of railway labor is too delicate and has too long a history for this code to upset established relationships. The balance has been struck over the years. This provision continues that balance unchanged.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 423 (1977).

Even after legislative efforts to clarify the relationship between §§ 77(n) and 77(b)(5), it is apparent that there remains room for considerable disagreement on the subject. Although our conclusion regarding the uncertainty surrounding the interpretation of the ELMPA and the WJPA makes it unnecessary for us to answer the question, the evident confusion as to the proper relationship between §§ 77(n) and 77(b)(5) would have further muddied the parties' conceptions of their legal rights under existing labor protection agreements.

3. *ICC Action*

In addition to the possibility of labor protection obligations arising from existing agreements, the ICC might have imposed labor protection obligations on the Ts as a condition of its approval of the proffered transactions. The GPs contend that the ICC would have considered the Ts' dispositions under § 5(2) of the Interstate Commerce Act, which requires the Commission to impose labor protection conditions as a condition of approval of a transaction. The GPs also argue that, even if the transactions had been processed under § (18), the ICC would have exercised its discretion and imposed labor protection conditions as part of the proffered transactions. 5 GP at S 120-21.

Section 5(2) applies, *inter alia,* to transactions wherein "two or more carriers . . . consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership". Section 1(18) is applicable to "the extension of . . . [a carrier's] line of railroad, or the construction of a new line of railroad or . . . [the acquisition or operation of]

any line of railroad" and to any action whereby a carrier "abandon[s] all or any portion of a line of railroad".

The Ts argue that these statutory provisions are illuminated by a series of ICC decisions involving entire line abandonments in which the Commission permitted the railroads to proceed under § 1(18) rather than § 5(2). *Okmulgee Northern Ry.—Abandonment of Entire Line*, 320 I.C.C. 637 (1964), exemplifies this line of cases. In *Okmulgee*, a railway applied for permission to abandon its entire twelve-mile line, while a second railroad applied simultaneously for permission to acquire and operate portions of the abandoned trackage. The ICC, rejecting an objection by labor representatives, held that the transaction fell outside the scope of § 5(2), and that § (2)(f)'s compulsory labor protection provisions therefore were inapplicable. *Id.* at 645-46. The ICC explained:

> This transaction does not involve a merger or consolidation in the sense contemplated by . . . [§ 5(2)'s] congressional purpose. There is no consolidation of carrier interests, or joining of two or more carriers, with a consequent temporization of competition. There is merely the expiration of one carrier which, because of business adversity, is no longer able to successfully compete; and the willingness of another to move into the vacuum to the extent some need might remain for rail service.

Id. at 639. The ICC also declined to exercise its discretion under § 1(18) to impose labor protection conditions. The Commission stated that, "the imposition of protective conditions in proceedings . . . where a carrier proposes to abandon its entire line of railroad normally is not warranted", *id.* at 645, and observed that "a departure from this principle in particular cases must be supported by clear and convincing evidence", *id.* The Commission relied on similar reasoning in later decisions reaching the same conclusion.[137]

The GPs argue that the Ts' reliance on the *Okmulgee* line of cases is misplaced in that "none of the cases on which the transferors . . . rely involved a significant impact on regional or national rail transportation because each carrier was small and employed relatively few workers." 5 GP at S 147. The apparent thrust of the GPs' distinction is that there is comparatively little need for § 5(2)(f)'s mandatory labor protection provisions where only a few employees are adversely affected. Under these circumstances, dismissed and displaced employees can be absorbed into other rail systems with little difficulty, thereby reducing the risk of both hardship and labor unrest.

Resolution of the question whether § 5(2) or § 1(18) would have been applicable in the alternative scenario presents difficult legal questions. Although we would lean slightly towards accepting the GPs' distinction, we note that in several cases the ICC refused to apply § 5(2)(f) where the track abandonments—and numbers of adversely effected employees—were fairly substantial. *E.g., Tennessee Central Ry.—Abandonment of Operations,* 333 I.C.C. 443, 444-45 (1968) (287 miles of track abandoned; 279 covered employees affected); *Rutland Ry.—Abandonment of Entire Line,* 317 I.C.C. 393, 394, 404 (1962) (332 miles of track abandoned; 489 workers affected). These decisions, however, did not occur, as our case would have, in the context of large-scale regional abandonments and reorganizations. Had all the Ts elected to deny their employees labor protection and seek ICC approval under § 1(18), thousands of railway workers would have been affected. Kasher (S) (Nov. 1, 1979) at 15. This situation would have demanded a response from the Commission entirely different from that required in the *Okmulgee* line of cases cited above. The unusual need for ICC imposition of labor protection that would have arisen in the proffered transactions if the Ts had attempted to avoid making protective payments to their employees might well have resulted in a decision by the Commission to reject the *Okmulgee* cases and require the Ts to proceed under § 5(2). Moreover, the acquiring

lines might well have insisted that the proceeding take place under that section in order to obtain the benefit of the antitrust immunity afforded by § 5(11). Finally, even if the ICC had processed the transactions under § 1(18), we think it might have determined that the standard articulated in *Okmulgee* governing the discretionary imposition of labor protection conditions was satisfied. See p. 112, *supra*.

If faced with the task of attaching labor protection conditions to the proffered transactions, the ICC would likely have adopted a set of benefits similar to those set forth in its decisions in *New Orleans Union Passenger Terminal Case*, 282 I.C.C. 271, 281-82 (1952); *Chicago, Burlington & Quincy R.R. Abandonment*, 257 I.C.C. 700, 704-07 (1944); *Oklahoma Ry. Trustees—Abandonment of Operations*, 257 I.C.C. 177, 197-201 (1944). The Commission relied on these decisions frequently in setting labor protection conditions under §§ 5(2) and 1(18) in the period between 1950 and 1976, and we think it likely that decisions in the alternative scenario would have reflected these precedents. Despite this conclusion, we doubt that the ICC would have had to decide the issue. Instead, we find that, in light of the uncertainties discussed above, negotiations between the parties would have produced an agreement, thus obviating the need for litigation before the ICC regarding the imposition of labor protection conditions.

4. *The Negotiating Process*

We find considerable support in the views of the parties for our conclusion that the level of labor protection benefits would have been decided through negotiations, rather than a new litigation or arbitration. According to EL, "EL and the Government Parties agree that a new agreement would have been reached, albeit with substantially different terms." ELRB at 214. LV does not disagree with this statement, but contends that it would not have entered into a new labor protection agreement which afforded LV

employees benefits higher than those provided by existing agreements. The GPs correctly observe that "virtually every witness who considered the question supports the conclusions that, if the alleged sales had occurred, the transferors, purchasers, and unions would have negotiated new, comprehensive agreements providing labor protection benefits for adversely affected employees". 2 GPRB at S 6 (footnote omitted). *Cf. Norfolk & Western R.R.* v. *Nemitz*, 404 U.S. 37, 42 (1971) (rail consolidations are generally accompanied by new agreements regarding labor protection).[138]

New labor protection agreements would have been attractive to the parties for a number of reasons: the Ts would have avoided the delays and risks of strikes that labor opposition would have involved; the acquirers would have avoided these dangers, and would have been able to resolve questions relating to the integration of the Ts' lines and employees into their systems; and unions could have obtained protections for their members without risking the disastrous loss of jobs that would have accompanied a complete shutdown of the Ts' lines. New agreements would have eliminated the uncertainties surrounding existing legal rights of the parties, and would have facilitated the rail use sales, which offered substantial benefits for all parties involved.

Despite their consensus regarding the likelihood of new labor protection agreements, the parties draw strikingly different pictures of the bargaining process. The GPs, pointing to what they see as an historical trend towards increased labor protection, argue that existing agreements such as the ELMPA and the WJPA would have provided a floor for benefits in the new agreements, 5 GP at S 179, and that labor's efforts to expand upon these existing protections would have been successful. The GPs conclude that the new agreements would have provided the "attrition protection" of the ELMPA for most of EL's employees, and the "Amtrak C-1"[139] protections for all other employees. 2 GPRB at S 75. The Ts respond that the possibility of a shutdown of their lines, and the consequent loss of jobs, would have placed

labor in a precarious bargaining position. 2 ELF at 554. They contend that the inapplicability of the WJPA and the ELMPA would have prevented these agreements from providing a floor for the levels of benefits in the new agreements. Accordingly, the Ts postulate a widespread retreat by labor from historical levels of labor protection.[140]

We find neither description of the labor protection bargaining process persuasive. The historical trend towards increased labor protection is not so one-sided as the GPs suggest, as the concessions by labor in the subsequent liquidations of the Rock Island and Milwaukee railroads indicate.[141] More fundamentally, the bargaining position of labor would have been weaker in the circumstances of the proffered transactions than was historically the case. The unprecedented possibility that—without federal intervention—most railway jobs in the Northeast would have been lost would have substantially restricted labor's bargaining power; the consummation of the proffered transactions would have been as important to the unions as it was to the Ts. Shannon (D) (Jan. 14, 1981) at 67-38, EL App. N at 375-76; Maxwell (S) (EL) (Oct. 15, 1980) at 4-5. As discussed above, the uncertainty surrounding the existing agreements would have made labor disinclined to resort to arbitration. An adverse decision would have been accompanied by a loss of labor's bargaining power, both because of the loss of a negotiating "chip" and the inflexibility of a bargaining position grounded primarily upon the self-destructive threat of strikes.

The Ts' contention that labor would have "panicked" in the proffered transactions, Shannon (D) (Jan. 15, 1981) at 652, 30 GP Supp. App. at 179, is equally overstated. Labor's ability to demand arbitration of the existing labor protection agreements, and the threat of labor unrest and strikes, are inconsistent with the notion of a widespread retreat on labor protection issues. As the parties recognize, strikes would have "virtually foreclosed" rail use sales because of the disastrous effect that even relatively short shutdowns would have had on traffic patterns and earnings

values. 2 GPRB at S 17-18; 1 RF at 35; Shannon (D) (Jan. 13, 1981) at 204-05, 30 GP Supp. App. at 75-76. Although extremely costly to labor as well as to the Ts, labor's ability to deny the Ts the economic benefits of the rail use sales at prices exceeding X by striking would have prevented any wholesale abandonment by labor of historical levels of labor protection.

We conclude that the Ts and labor would have occupied roughly equal bargaining positions. Each possessed the ability to inflict serious costs on the other, yet only by accepting comparable costs themselves. Neither had ironclad cases under existing laws and agreements, yet both could have credibly threatened resort to litigation. All parties would have derived substantial benefits from consummation of the rail use sales. These considerations would have resulted, in all likelihood, in a relatively evenhanded compromise based roughly on historical levels of labor protection.

Before discussing the precise terms of the labor protection agreements that we find the parties would have agreed to, we return to a point noted briefly at the beginning of this Part. The amount of labor protection benefits that unions could obtain would have been limited by the amount by which the proceeds of the rail use sales would have exceeded proceeds from sales for scrap.[142] Since, however, neither labor nor the Ts would know exactly what this excess would be, we do not think the bargaining would have proceeded with this particular figure in mind. Rather the parties would have reached what seemed a reasonable position in the light of the considerations we have discussed, and a T would then have had to decide, on the basis of admittedly imperfect data, whether to sign an agreement embodying that position or to break off the negotiations and abandon or sell at scrap value, which is the most that a buyer unprotected by an agreement would pay.

Although numerous considerations, none of which is easily quantified, would have affected the labor protection negotiations,[143] the bargaining process we have outlined above permits a

very rough prediction of the likely terms of the new labor protection agreements. As we explain below, this bargaining process would have settled on levels of labor protection roughly equivalent to the *New Orleans* conditions that the ICC historically has imposed under § 5(2) of the Interstate Commerce Act.[144] Stated briefly, the *New Orleans* benefits provided for 100 percent of an employee's earnings (for both displaced and dismissed employees) for up to four years following the ICC order approving a transaction plus any residual benefits under the five-year term of the WJPA. Alternatively, there is provision for a lump sum separation payment for dismissed employees at the employee's option. Both dismissal allowances and lump sum separation payments vary in accordance with the length of service of particular employees.

Several considerations support our choice of *New Orleans* benefits as the approximate level of labor protection that the new agreements would have required. As the GPs note, this level of labor protection was imposed by the ICC on numerous occasions between 1950 and 1976, albeit principally in contexts other than complete abandonments.[145] Thus, all parties would have been familiar with the *New Orleans* conditions. This, and the perception of fairness that would have accompanied the choice of ICC-sanctioned levels of protection, would have made the *New Orleans* benefits a palatable compromise for all parties. Moreover, none of the parties would have felt that acceptance of this commonly used set of conditions would set an adverse precedent for future labor protection negotiations. Lastly, benefits based on the *New Orleans* decision would have represented a genuine compromise—providing labor with substantial protections while relieving the Ts of the potential burden of attrition protection.

A similar bargaining process would have governed discussions on other terms of the labor protection agreements. The Ts (and the acquirers) would have been anxious to obtain broad power to transfer employees, both to permit efficient use of labor resources and to minimize labor protection costs. The GPs, relying in part

upon existing agreements limiting EL's right to transfer employees, see agreements cited in 2 GPRB at S 14 n.29, and in part upon limitations contained in labor protection agreements negotiated in other liquidations, see Milwaukee Agreement cited in ELRB at 217 n.225, argue that the Ts would have been unable to obtain unrestricted transfer rights in the new agreements. We find the GPs' reasoning persuasive. Although we do not attempt to reach a precise determination of the issue, we conclude that management would have obtained transfer rights subject to payment of relocation costs and reasonable geographical restrictions.

We also conclude that the new agreements would have contained a compromise regarding protection for non-union employees. Labor would have had considerably less incentive to obtain benefits for this group than for union members. Non-union employees, however, had historically received labor protection benefits as a result of ICC conditioning. See, *e.g., Norfolk & Western Ry. and New York, Chicago & St. Louis R.R.—Merger,* 330 I.C.C. 780, 825 *modified,* 331 I.C.C. 22, *aff'd sub nom. Erie Lackawanna R.R.* v. *United States,* 279 F. Supp. 316 (S.D.N.Y. 1967), *aff'd sub nom. Pennsylvania Central Merger and Norfolk & Western Inclusion Cases,* 389 U.S. 486 (1968) (affirming decision by ICC in which Commission extended labor protection to non-union employees). Nonetheless, protection typically was not extended to supervisory, professional, and executive employees. We conclude that the agreement reached by the parties would have been roughly along the lines of anticipated ICC actions: nonunion operating employees would have been protected and a substantial number of nonunion nonoperating employees would not have been protected.

C. *Calculation of Labor Protection Costs*

As noted at the outset of this Part, the labor protection costs (LPCs) that would have arisen from the new agreements must be deducted from the rail use sales values realizable by the Ts. We think this deduction would have taken the form of a reduction in

the purchase price the acquirers would have paid for the Ts' lines and an assumption by the acquirers of the Ts' labor protection obligations. The Ts would have preferred this arrangement because, by relieving their estates of ongoing LPCs, a speedier distribution of sales proceeds would have been possible. Labor and the acquirers would have desired the arrangement because, by removing the Ts from the picture, it would have simplified their dealings with one another. This reduction would have been arrived at through bargaining between the Ts and the acquirers, which would have been based on the parties' calculations of projected LPCs. Two aspects of this bargaining process make it difficult for us to arrive at an exact estimate of the reduction in purchase prices that would have resulted from an acquirer's assumption of LPCs. First, as noted earlier, note 143, *supra,* any bargaining involves numerous unquantifiable variables. Second, projecting the costs of labor protection is extremely difficult:

> Total employee protection costs can be only rough estimates, since in many cases the actual costs will vary depending upon future events, the state of the economy and decisions made by others.

I FSP at 164. See Ables, *supra,* at 117. Despite these difficulties we think we can arrive at reasonable estimates of the LPC reductions in the purchase prices for the Ts' properties.

The first step in our analysis requires us to determine what an acquirer's management would have projected its LPC liability resulting from the proffered transaction to be. Arriving at an estimate of future LPCs demands consideration of numerous variables—the number of employees adversely affected by the proffered transaction, the average length of service and yearly compensation of a T's employees, the attrition rates applicable to the Ts' workforces, the rate of rehiring of dismissed employees, and so forth. There is little agreement among the parties on these issues or on a methodology for calculating LPCs. In the following sections we attempt to determine what assumptions

regarding these variables the acquirers would have made and what methodology they would have employed in projecting LPCs. We recognize that any one of numerous methods of calculating LPCs could be adopted, but think that the conclusions we reach below approximate the projections that an acquirer would have made. Our task has been made somewhat easier in that, for reasons appearing elsewhere, we need make such projections only for EL, LV and AA.

The second step in our determination of the reduction in acquisition price attributable to LPCs involves consideration of the effect of bargaining between a T and acquirers on these LPC estimates. We address this issue in the section following our discussion of the acquirers' LPC estimates.

1. *Erie Lackawanna*

(a) *Operating Employees*

(i.) *Number of Adversely Affected Employees.* The first step that an acquirer would take in calculating LPCs would be estimating the number of employees who would be adversely affected by the proffered transactions. We discuss the LPCs attributable to EL's operating employees separately from those attributable to nonoperating employees because of the differences in the methodologies chosen by the parties. We first consider the GPs' contentions regarding this issue. The GPs' LPC study was prepared by Richard Kasher.[146] Kasher's study was based on Conrail's Title V Data Base and a Conrail computer model designed, in part, to estimate LPCs. The Data Base contains information relating to subjects such as seniority, age, date of entrance into service, and prior earnings, for every employee of the Ts. Kasher (S) (Nov. 1, 1979) at 16-17. Using the Title V Data Base, Kasher estimated the number of adversely affected employees in each of the Ts' seniority districts, by assuming that the number of such employees would have been directly related to the track and facility abandonments. Kasher (S) (Nov. 1, 1979) at 12-14. Based on these assumptions, Kasher calculated

that 16,626 PC union employees, 3,213 EL union employees, 1,346 R union employees, and 482 LV union employees would have been dismissed in the proffered transactions. *Id.* at 15. Kasher also estimated that 60 percent of the Ts' "non-agreement employees"[147] would have been terminated.[148]

We begin our analysis of the LPCs attributable to EL's operating employees by rejecting Kasher's method of computing the numbers of operating employees that would have been adversely affected by the proffered transactions. Kasher's assumption that there would have been a direct correlation between the track mileage abandoned and the employees terminated is flawed in several respects. Kasher explicitly concedes that this assumption is inaccurate in many instances, and notes that had he had "more time and resources" he would have considered other factors in his analysis. *Id.* at 13-14. The failure to take into account considerations such as general manning requirements for the various acquisitions proffered by EL, proposed rehabilitation and capital improvement programs, and traffic retention data substantially reduces the value of Kasher's estimates of the number of employees adversely affected in the alternative scenario. Maxwell (S) (Oct. 15, 1980) at 6; Grotz (S) (Oct. 15, 1980) at 15-16. Moreover, Kasher's study completely ignores the labor expenses reflected in EL's earnings projections. In order for any degree of consistency to exist between EL's LPCs and its rail use sales values—which are based on the levels of employment reflected in the pro formas—EL's projected operating expenses must serve at least as a starting point for estimating reduction in its workforces.[149]

Even if we were to accept the conceptual basis of Kasher's method of estimating the number of adversely affected EL employees, we would be forced to reject the results of his study because of serious flaws in its execution. First, it was premised on what would have happened to EL in the PC's "refined case",[150] and not on the dispositions proffered by EL. Although the PC refined case was similar to the EL-LV Chessie acquisition, there

were substantial differences between it and the EL-LV Western acquisition, which is the relevant acquisition for our purposes.[151] Second, the personnel supervised by Kasher interpreted his instructions concerning estimating the number of adversely affected EL employees in a variety of inconsistent fashions,[152] and misunderstood important aspects of their assignments.[153] We are unpersuaded by the GPs' attempt to characterize these occurrences as "refinements" that "only enhanced the accuracy" of Kasher's study. 5 GP at S 209 n.44. The ad hoc adjustments to Kasher's methodology were undertaken by individuals with no experience in labor protection studies, and without knowledge of EL's traffic department.[154] We find the combination of conceptual flaws and mistakes in execution that marked Kasher's study to be so serious that, as regards its estimates of the number of adversely affected employees, it cannot provide even a starting point for our attempt to duplicate an acquirer's calculation of EL's LPCs.

EL's estimates of the number of adversely affected employees are derived from Charles Shannon's LPC study.[155] Shannon (S) (Oct. 15, 1980). The methodology of the Shannon study differed in a number of respects from that of the Kasher study. Based on a comparison of lines 1-13 and 19 of the pro formas for the EL Western acquisition with EL's Annual Report to the ICC (R-1 report) for 1973, 32 GP Supp. App. at 537, Shannon calculated the change in operating expenses of the system that the proffered transaction would cause. Shannon (D) (Feb. 11, 1981) at 1063-76, EL App. N at 404-17. Relying on the labor portion of this reduction in EL's operating expenses, Shannon calculated the number of jobs that would be eliminated as a result of the proffered transaction as well as the types and locations of jobs that would be lost. *Id.* Shannon viewed this figure as the number of employees *potentially* adversely affected by the proffered transaction. He reduced the figure by (1) the number of positions in the EL system that would be opened by attrition; and (2) the number of new positions that EL's capital improvement

projects, normalized maintenance programs, and rehabilitation projects would have required. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 1-6, EL App. N at 517-22. Shannon concluded that because of these factors, EL's employment needs would have almost completely offset the reduction in jobs reflected in EL's Western acquisition pro formas.

Shannon testified that only two isolated groups of EL operating employees would have been both adversely affected by the proffered transactions and unable to find employment elsewhere on the EL system. In all four proffered transactions 68 marine employees in the New York Harbor would have been terminated. ELRB at 203. In the Chessie acquisitions a number of employees at the Marion Yard would have been dismissed. Aside from these two groups, however, Shannon concluded that no EL operating employees would have been eligible for labor protection benefits.

The GPs claim Shannon's results to be suspect as a Dr. Pangloss approach. It seems almost impossible that EL could have managed so perfectly that attrition and new job opportunities arising from its rehabilitation and capital improvement programs would counterbalance the hundreds of jobs that would be lost as a result of abandonments. Beyond this we have some more detailed misgivings regarding certain aspects of Shannon's study. Shannon performed actual calculations of the number of adversely affected employees only for the EL Western acquisition. Although these figures can provide a foundation for our discussion, which principally concerns the EL-LV Western acquisition, we must adjust these conclusions to reflect the abandonment of EL's Scranton line in the EL-LV combination. Moreover, we note that Shannon's "study", as it appears in Exhibit 16 to Shannon's disposition, was submitted long after he had prepared his statement announcing his conclusions regarding EL's LPCs. Shannon (D) (Feb. 11, 1981) at 1188-94, 30 GP Supp. App. at 273A-273G.

Despite these reservations we believe Shannon's LPC study provides a sufficient basis for calculation of EL's LPCs. As discussed above, Shannon's calculations posited a substantial reduction in the number of EL operating *positions*. Based on Shannon's workpapers, we calculate that Shannon concluded that 1,819 EL operating jobs would have been eliminated in the five years following the EL Western acquisition. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 1-6, EL App. N at 517-23.[156] We accept the figures contained in Exhibit 16 as reasonable estimates of the number of operating positions that would have been eliminated as a result of the proffered transactions. Although Shannon did not specifically consider the effects on employment of each of the operating changes reflected in the EL pro formas, sheets 1-16 of Exhibit 16 indicate that Shannon did consider the major dislocations that the proffered transactions caused—the Marion and Croxton Yard projects, the abandonment of 700 miles of trackage, and the acquisitions of labor-saving equipment. Although we have some reservations regarding the apparent exclusion of the smaller operating changes from Shannon's study, we are willing to discount the effect of these changes. EL's witnesses testified that small, isolated employment reductions could be managed so as to minimize LPCs through the use of attrition and by bargaining with unions. Shannon (S) (Oct. 15, 1980) at 11-12. See also Maxwell (S) (Oct.15, 1980) at 8-11. Since there is no particularized rebuttal by the GPs of Shannon's conclusions regarding the number of jobs that would have been lost in the proffered transactions, we find these estimates sufficiently accurate to serve as a base for our calculations.

(ii.) *Attrition and Rehire Rates.* We take a different view, however, of Shannon's application of attrition rates and rehire rates to these figures. Despite his view that more than 1,800 operating *positions* would be eliminated in the proffered transactions, Shannon concluded that virtually no operating *employees* would have been adversely affected. As noted above, Shannon's

determination was based principally on his use of attrition and rehire rates.

Relying on EL's historical experience, Shannon calculated and applied an individual attrition rate for each of the six "ICC Groups"[187] that he determined would be effected by the proffered transactions. These rates ranged from 5.5 percent for dispatchers to 20.5 percent for watchmen. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 1-6, EL App. N at 517-23.

Exhibit 16 reflects two different treatments of the rehire rate issue. For ICC Group II, Shannon assumed—without explanation—a rehire rate of 50 percent. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheet 1, line 16, EL App. N at 517. For all other EL operating employees (ICC Groups III, IV, V, VIa, and VIb) Shannon apparently assumed a 100 percent rehire rate. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 2-6 , EL App. N at 518-23.

We base our calculations on a methodology somewhat different from that used by Shannon. Rather than applying the relevant individual attrition rates to particular ICC Groups, we apply a systemwide average attrition rate to EL's entire pool of operating employees. We adopt this approach principally to facilitate our computation of EL's labor protection costs. Our methodology, however, does EL no injustice: the attrition rate we use (10.4 percent) is simply the weighted average of the attrition rates applied by Shannon. Indeed, by applying attrition and rehire rates on a systemwide basis, rather than treating ICC Groups individually, we increase the extent to which job openings in one ICC Group can be filled by dismissed employees from other ICC Groups. Similarly, the GPs have no cause for complaint. Kasher used a systemwide attrition rate (10.8 percent) that was higher than that we apply here. Kasher (S) (Nov. 1, 1979) at 23-26.

Although we thus accept the attrition rate applied by Shannon, we reject his assumptions regarding rehire rates. The record contains a startling variety of rehire rates: Shannon used both 100

percent and 50 percent; Kasher used 50 percent, which he felt was extremely conservative; PC, in a 1966 study, estimated 33 percent and Grotz used both 100 percent and 20 percent.[158] We are impressed by the arguments advanced in support of the lower rehire rates. As Kasher commented, "Rail employees are not fungible", Kasher (S) (Nov. 1, 1979) at 26. In order to obtain personnel with the requisite skills for a particular position, those managing EL's system frequently would have had to look beyond the pool of surplussed EL employees. In addition, management's ability to rehire surplussed employees would have been limited by timing difficulties; many positions would have had to be filled quickly to maintain operating efficiency. Moreover, as discussed above, labor would have demanded reasonable restrictions on an acquirer's transfer rights, and the new labor protection agreements would have contained features such as geographical restrictions on transfer rights, as well as provisions regarding seniority, craft, and class limitations that would have restricted management's ability to fill job openings with surplussed employees, see pp. 117-118, *supra*. Kasher (S) (Nov. 1, 1979) at 26-27; Grotz (S) (Oct. 15, 1980) at 24-25. Lastly, the acquirers would have been inclined to take a relatively conservative view of the rehire rate, particularly in the context of negotiations with the Ts. Although we can do no more than provide a rough estimate, these considerations suggest to us an overall rehire rate for EL operating employees in the range of 33 percent. We apply this rate both to positions opened by attrition and to positions created by rehabilitation and capital improvement programs in order to determine the extent to which these positions could have been used to reduce the number of EL employees dismissed.

As noted above, we accept Shannon's raw data regarding the number of jobs that would have been lost in each of the years following the proffered transactions. These figures, according to our calculations,[159] are as follows:

Appendix H

Table 1

Number of Positions Eliminated Following Acquisition

Year 1	318
Year 2	543
Year 3	539
Year 4	418
Year 5	1
Total	1,819

These figures, reflecting reductions in the number of operating *positions*, must be adjusted to reflect the number of *employees* who either would have been rehired shortly after dismissal or would not have been terminated because of the creation of new jobs or vacancies in existing positions due to attrition. First, we apply the 10.4 percent attrition rate to the total number of EL operating employees in each of the years following the proffered transaction. Our computations indicate that the following number of operating positions would have been vacated each year due to attrition:[160]

Table 2

Attrition-Created Positions

Year 1	961
Year 2	992
Year 3	970
Year 4	921
Year 5	884

Based on Shannon's data, see Shannon (D) (Feb. 11, 1981), Ex. 16, at sheets 1-6 EL App. N at 517-23, which relied on EL's pro formas, we calculate that the following number of new positions would have been available each year as a result of EL's rehabilitation and capital improvement programs:[161]

Appendix H

Table 3

New Positions Available Following Acquisition

Year 1	616
Year 2	334
Year 3	67
Year 4	68
Year 5	69

Adding the two sets of figures in Tables 2 and 3 produces the following figures for the total number of annual employment openings in the EL system in the years following acquisition:

Table 4

Vacant Positions Following Acquisition

Year 1	1577
Year 2	1326
Year 3	1037
Year 4	989
Year 5	953

Application of the 33 percent rehire rate arrived at above to these totals produces the following figures for the number of operating positions opened by attrition or newly created that an acquirer's management would have been willing to consider available to reduce the number of EL operating employees that would be surplussed:

Table 5

Rehires and Nondismissals

Year 1	1577 x 33%	=	520
Year 2	1326 x 33%	=	438
Year 3	1037 x 33%	=	342
Year 4	989 x 33%	=	326
Year 5	953 x 33%	=	315

Subtraction of these figures from the numbers of EL operating positions eliminated each year (Table 1) produces the number of EL operating employees who would have been eligible for labor

protection benefits each year following the proffered transactions:[162]

Table 6

Employees Dismissed Following Acquisition

Year 1	(202)*
Year 2	105
Year 3	197
Year 4	92
Year 5	(314)*

* Numbers in parentheses indicate need for new hires in excess of surplussed employees pool.

(iii.) *Lump Sum Separation Payments.* Under the *New Orleans* benefits formulas surplussed employees are offered a choice between a monthly dismissal allowance and a lump sum separation payment, see p. 117, *supra.* Calculation of EL's LPCs requires an estimate of the number of employees who would have chosen each of these types of benefits. Both Shannon and Grotz assumed 50 percent of EL's operating employees would have chosen lump sum payments. Their conclusions were based on the view that EL's employees would have been confident that they could find other employment and that, therefore, a lump sum payment would be preferable to a dismissal allowance that, in theory, would be reduced by outside earnings. Shannon (S) (Oct. 15, 1980) at 17-18; Grotz (S) (Oct. 15, 1980) at 27-28 & n.17. Kasher, in contrast, assumed that only 25 percent of EL's employees would have chosen a lump sum payment, because of the importance to EL employees of fringe benefits and the possibility of reemployment on the EL system with continued seniority rights that would have been lost by the choice of the dismissal allowance option.

On the whole we find the Ts' 50 percent figure closer too the mark than the GPs' estimate.[163] Seniority rights would have been of comparatively little importance to less senior EL employees who, because dismissals would have been in reverse order of

seniority, would have constituted the majority of surplussed employees. We feel compelled, however, to reduce the Ts' figure to 40 percent to reflect the reluctance of EL's employees to re-enter the job market without the protection of a monthly dismissal allowance. Kasher (S)(Nov. 1, 1979) at 17-18.

Application of this figure to the total number of EL operating employees who would have been eligible for labor protection benefits in each of the years following the proffered transaction (Table 6) produces the following figures:

Table 7

Dismissed Employees Electing Lump Sum Payments

Year 1	0
Year 2	42
Year 3	79
Year 4	37

Calculation of the costs that would have resulted from lump sum payments to these employees requires consideration of several factors. First, we must estimate the average base period salary of the employees choosing lump sum payments. We arrive at this figure by first calculating a weighted average of the average yearly compensation rates of various groups of EL employees in 1973. According to our calculations, the average 1973 salary of EL operating employees was approximately $11,800. We adjust this figure to obtain figures for 1975—the year preceding the date when we believe the proffered transaction would have occurred—by applying "growth factors" prepared by a PC witness, Richard Olsen, and relied upon in the Grotz LPC study. Grotz (S)(Oct. 15, 1980) at 25 Table 6 n.5, citing Olsen (S)(Cost and Revenue) (Dec. 1, 1978) at 17 & Table B-8. These factors reflect the real increase of railway wages during the relevant period. Based on these figures we calculate that the average yearly compensation (in 1973 dollars) for EL employees in these years would have been:

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Table 8
Real Railway Wage Projections

1973	$11,800
1974	$11,800 x 1.024 = $12,083
1975	$11,800 x 1.024^2 = $12,373
1976	$11,800 x 1.024^3 = $12,670
1977	$11,800 x 1.024^4 = $12,974
1978	$11,800 x 1.024^5 = $13,286
1979	$11,800 x 1.024^6 = $13,605

Next, we adopt crude adjustments to these figures to reflect the fact that most of the employees who would have been dismissed would have had less seniority, and therefore lower average annual compensation rates, than the average EL operating employee. In addition, we adjust these figures to reflect the fact that, because the proffered transactions would have taken place on April 1, 1976, the average base period compensation would have comprised eight months of 1975 wages and four months of 1976 wages:

Table 9

Dismissed Employee Average Wage

1975	$12,373 x 95% = $11,754
1976	$12,670 x 95% = $12,037
1977	$12,974 x 95% = $12,325
1978	$13,286 x 95% = $12,622
1979	$13,604 x 95% = $12,924

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Base Period Salaries

Employees Dismissed in Period Starting:

4/76	$11,754 x 67% =	$ 7,875
	$12,037 x 33% =	$ 3,972
		$11,847
4/77	$12,037 x 67% =	$ 8,065
	$12,325 x 33% =	$ 4,067
		$12,132
4/78	$12,325 x 67% =	$ 8,258
	$12,622 x 33% =	$ 4,165
		$12,423
4/79	$12,622 x 67% =	$ 8,457
	$12,924 x 33% =	$ 4,265
		$12,722

The *New Orleans* benefits provided for varying levels of lump sum separation payments depending upon the length of an employee's service with a carrier. The applicable figures are as follows:

Table 10

Length of Service	*Benefit Level*
1-2 years	3 months pay
2-3 years	6 months pay
3-5 years	9 months pay
5+ years	12 months pay

See WJPA, Ex. GPS - Labor - 10 at 176.

Accordingly, we must estimate the number of employees choosing lump sum payments who would have fallen into each of these categories. The record contains very little evidence on this

issue. Grotz adopts certain assumptions regarding the LV workforce, which may be taken to be roughly applicable to EL. Grotz's figures place the vast majority of employees choosing lump sum payments in the 5+ years of service category, a result we accept principally because the acquirers would have been inclined to insist on a conservative projection. Grotz (S) (Oct. 15, 1980) at Table 4, 5.[164] Application of these figures to the *New Orleans* benefit formulas and to the average base period compensation rates set out above produces the following cost of lump sum payments in the EL Western acquisition:

Table 11

*Lump Sum Payments**

Year 1	0	
Year 2	1 x .25 x $12,132	= $ 3,033
	2 x .5 x $12,132	= $ 12,132
	3 x .75 x $12,132	= $ 27,297
	36 x 1 x $12,132	= $436,752
Total		$479,214
Year 3	1 x .25 x $12,423	= $ 3,106
	4 x .5 x $12,423	= $ 24,846
	6 x .75 x $12,423	= $ 55,904
	68 x 1 x $12,423	= $844,764
Total		$928,620
Year 4	1 x .25 x $12,722	= $ 3,181
	2 x .5 x $12,722	= $ 12,722
	2 x .75 x $12,722	= $ 19,083
	32 x 1 x $12,722	= $407,104
Total		$442,090
Grand Total		$1,849,924

* Source for number of employees receiving payments: Table 7.

(iv.) *Dismissal Allowances.* The next step in our calculation of EL's LPCs requires computation of the cost of dismissal payments made to surplussed EL operating employees. As suggested above (Tables 6 & 7), the following numbers of EL operating employees would have chosen to receive dismissal allowances in the years following the proffered disposition:

Table 12

Dismissed Employees Electing Dismissal Allowances

Year 2	63
Year 3	118
Year 4	55

We must adjust these figures to reflect the effect of rehiring surplussed employees into positions opened by attrition or created by EL's rehabilitation and capital improvement programs (Table 5):

Table 13

Employees Receiving Monthly Dismissal Allowances

	Year	*1*	*2**	*3**	*4**	*5***	*6*
Employees	1	0	0	0	0	0	0
Dismissed	2	-	63	63	63	0	0
in Year:	3	-	-	118	118	0	0
	4	-	-	-	55	0	0

* Rehire rates were taken into account in determining the number of employees assumed surplussed each year. See p. 128-29, *supra.* Consequently, we make no allowance for rehires here, to avoid double-counting with Tables 5 & 6. We assume, as we think an acquirer would have, that the excess available positions in year 1, see Table 6, would not be available for surplussed employees in later years, because of timing difficulties and efficiency requirements.

** 314 rehires, as reflected in Table 6. All rehires assumed to come from earliest group possible. Thus, 314−63−118−55=78, is greater than 0, as reflected in year 5.

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The *New Orleans* benefits provide for dismissal allowances of 100 percent of an employee's base period compensation, calculated at pp. 131-32, *supra*, minus any outside earnings or unemployment compensation received by an employee. The record contains two different conclusions with respect to this latter issue. Kasher, on the assumption that employees receiving dismissal allowances would not report their outside earnings, did not make any adjustment in the cost of dismissal allowances to reflect outside earnings. Kasher (S) (Nov. 1, 1979) at 21. Grotz adopted a figure based upon an assumption that each employee dismissed would find employment three months following dismissal at a salary equivalent to 50 percent of pre-dismissal earnings increased to reflect general wage escalations. Grotz justified this assumption on the grounds that employees would not have "flouted the express direction of the ICC" and on the fact that an acquirer would have established a "prudent procedure" for ensuring that outside earnings were reported. Grotz (S) (Oct 15, 1980) at 28-29 & Table 9. We see no reason why an acquirer would not have considered itself able to achieve at least partial success in policing the reporting requirements of the new agreement. Based roughly on Grotz's calculations (with a crude downward adjustment to reflect enforcement costs and other difficulties), we adopt a 50 percent offset to monthly dismissal allowances to account for outside earnings.

Using the figures set out above regarding the average base period compensation of the employees choosing dismissal allowances (Table 9) and the figures relating to the numbers of EL operating employees receiving dismissal allowances (Table 13), we arrive at the following conclusions regarding the cost of monthly dismissal payments:

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Table 14

Costs of Monthly Dismissal Allowances

Year 1		0
Year 2	63 x $12,132 =	$ 764,316
Year 3	63 x $12,132 =	$ 764,316
	118 x $12,423 =	$1,465,914
Year 3 Total		$2,230,230
Year 4	63 x $12,132 =	$ 764,316
	118 x $12,423 =	$1,465,914
	55 x $12,722 =	$ 699, 710
Year 4 Total		$2,929,940
Year 5		0
Grand Total		$5,924,486
		x 50%
Total Cost of Monthly Dismissal Payments		$2,962,243

(v.) *Fringe Benefits.* The *New Orleans* benefits also guaranteed employees electing to receive monthly dismissal allowances fringe benefits, such as health and welfare benefits. Both Grotz and Kasher estimated that this item would result in LPCs equal to approximately 17 percent of the cost of dismissal payments, before reduction for outside earnings. Kasher (S) (Nov. 15, 1979) at 22-23; Grotz (S) (Oct. 15, 1980) at 29. Shannon apparently adopted a similar figure in the context of operating employees. We find Grotz's and Kasher's estimates—which are based on historical data compiled by the Railroad Retirement Board—reasonable and accept them for purposes of our computations. An acquirer likely would have calculated that total costs incurred as a result of fringe benefit payments to EL operating employees would have been:

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Table 15

Cost of Fringe Benefits

17% x $5,924,486 = $1,007,163

(vi.) *Relocation Costs.* There is general agreement among the various LPC studies regarding the cost of relocating an individual employee. Both Shannon and Kasher estimated relocation expenses of $4500 per relocated employee. 2 ELRB at 217 & n.226; Kasher (S) (Nov. 1, 1979) at 28. Grotz estimated that it would require $600,000 in moving expenses to relocate 120 LV employees, an average cost of $5000 per employee. Grotz (S) (Oct. 15, 1980) at 32. USRA, in the FSP, estimated $5000 in moving costs per relocated employee. 1 FSP at 165. We adopt the $5000 figure, because the Ts would have been required to pay both moving and other relocation expenses, thus requiring slight upward adjustments of the parties' figures.

There is very little evidence in the record concerning the number of EL employees who would have been eligible for reimbursement of relocation expenses. Shannon provides rough estimates for operating employees at the Marion shop and the marine workers at the New York Harbor, but does not address the issue as it relates to the EL system generally. Kasher, on the basis of his experience at Conrail, estimated that approximately 50 percent of all rehired employees would receive relocation benefits. Kasher (S) (Nov. 1, 1979) at 27. Although we are reluctant to apply this figure without some indication of the relevance of Kasher's Conrail experience to EL's case, the dearth of evidence on the subject in the record leaves us little choice. As reflected in Tables 1, 5, and 13 the following numbers of employees would have been rehired (or transfered prior to termination) in the years following the proffered transactions:

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Table 16

Rehired Employees

Year 1	318
Year 2	438
Year 3	342
Year 4	326
Year 5	236
Total	1,660

Application of the 50 percent rate (representing rehired employees eligible for relocation benefits) and the $5000 average cost per employee produces the following total cost of relocation expenses:

Table 17

Relocation Costs

1,660 × 50% × $5000 = $4,150,000

(vii.) *Displacement Costs.* The *New Orleans* conditions provide for payment of displacement expenses to employees who accept employment at salaries less than their base period compensation. As Kasher conceded, displacement allowances would have decreased rapidly in the years following the proffered transactions, principally because the earnings gap between base period compensation and yearly salaries would be eroded by general wage increases. Kasher (S) (Nov. 1, 1979) at 30. Kasher estimated that 12 percent of the surplussed employees rehired in the first year following acquisition would receive displacement allowances. His statement does not reveal his assumptions regarding later years, although in light of his general views that displacement allowances would have been concentrated in the period immediately following the proffered transactions, we feel safe in assuming that after year 1 this item may be disregarded as *de minimis*. Shannon apparently did not address this question in

the context of EL's operating employees. We adopt Kasher's 12 percent figure as a reasonable estimate of the number of employees that would receive displacement allowances.

We reject, however, Kasher's estimate of the average monthly displacement payment that EL operating employees would receive. Kasher used a figure ($2,717.04 per year) derived from the "average monthly displacement allowance *claim*" submitted to Conrail in 1978. As the Grotz study points out, Grotz (S) (Oct. 15, 1980) at 30, this figure is far larger than the average amount of displacement payments actually made by PC in 1973 and 1974: $76.28 per year. See I FSP at 165. Moreover, the Conrail figures relate to claims made under § 505(b) of the Rail Act, which—unlike the *New Orleans* benefits—adjusted an employee's base period compensation to reflect subsequent general wage increases. We find the figures relating to actual payments made by PC far more relevant to our inquiry than the claims submitted to Conrail, and accept the $76.28 figure. Indeed, because the PC payments were made primarily pursuant to agreements that adjusted base period salaries to reflect general wage increases, this figure is probably somewhat overstated. We accept it, however, on the theory that the acquirers would have made a conservative estimate of their potential LPC liability. Based on the total numbers of operating employees in EL's workforce following acquisition (Table 2 & note 160, *supra*), we calculate that LPCs attributable to displacement allowances would have totalled:

Table 18

Displacement Costs

9232 x 12% = 1108 displaced employees
1108 x $76.28 per claim = $84,518

(viii.) *LPCs Attributable to Abandonment of EL's Scranton Line.* As noted previously, Shannon's study addressed only the EL Western acquisition. Shannon testified, however, that the

EL-LV Western acquisition would involve identical LPCs. Although the EL-LV Western acquisition contemplated abandonment of the Scranton line, which would continue to rail use in the EL Western acquisition, Shannon concluded that all employees on this line would find employment on the nearby, parallel LV line. Shannon (D) (Jan. 15, 1981) at 724-26, EL App. N at 395-97. Positions on that line would have been available, according to Shannon, because of increased normalized maintenance and new rehabilitation expenses. Shannon (S) (Oct. 15, 1980) at 64; Adik (S) (Dec. 31, 1978) at 13-15. Although the GPs reject this contention, 2 GPRB at S-21, 26-27, they offer no particularized criticism of Shannon's assumption. Absent criticism, we accept Shannon's estimate, although we think it likely that an acquirer would have determined that some relocation expenses would have been involved, particularly in the MOW department. Based on our rough calculation of the number of employees who would have been effected and the average cost of relocating an employee, we estimate that the acquirers would have projected a cost of approximately $450,000 for this item.

(ix.) *Marine Employees.* Shannon determined, ELRB at 203, that in all four proffered transactions 68 marine employees working in the New York Harbor would have been terminated—a conclusion we accept. Shannon assumed that all marine employees would have chosen a lump sum payment rather than a monthly dismissal allowance, principally because of the existing employment opportunities with other operators in the New York Harbor area. Shannon (D) (Jan. 14, 1981) at 372-75, EL App. N at 352-53. We see no basis for questioning this conclusion, which was based on Shannon's personal knowledge of and experience in the New York Harbor. Shannon (D) (Feb. 11, 1981) at 1136-37, EL App. N at 456-57.

Shannon applied at 12 percent attrition rate to the 68 marine employees for the one year period preceding the acquisition, and concluded that only 60 employees would be employed in the harbor at the date of the acquisition. We adjust this figure

somewhat to reflect our finding that the 12 percent attrition rate is too high, adopting instead a 6 percent rate. Shannon conceded that such a rate would have been appropriate, and we think that an acquirer's management would have opted for the more conservative number. Shannon (D) (Jan. 14, 1981) at 366; EL App. N at 350. Accordingly, we conclude that 64 marine employees would have received lump sum severance payments. The average yearly wage in 1973 for these employees was $11,580. *Id.* Adjusting this figure to reflect the increase in real railway wages, we obtain an average 1975 base period compensation of approximately $12,145. See Table 8. Assuming, as we did in the context of operating employees in general, see pp. 132-33, *supra,* that LV's average length of service distribution would apply, and using the WJPA formula (Table 10), we conclude that the total lump sum payments that EL's marine employees would have received would have been:

Table 19

Marine Employees

1 x .25 x $12,145 =	$ 3,036
3 x .5 x $12,145 =	$ 18,218
5 x .75 x $12,145 =	$ 45,544
55 x 1.0 x $12,145 =	$667,975
Total	$734,773

(x.) *Total LPCs Attributable to EL Operating Employees.* Addition of the LPCs attributable to lump sum payments (Table 11), dismissal allowances (Table 14), fringe benefits (Table 15), relocation expenses (Table 17), displacement allowances (Table 18), EL's marine employees (Table 19), and abandonment of EL's Scranton line provides the following estimate of LPCs attributable to EL operating employees:

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Table 20

Total LPCs Attributable to EL Operating Employees

Lump Sum	$ 1,849,924
Dismissal	$ 2,962,243
Fringe Benefits	$ 1,007,163
Relocation	$ 4,150,000
Displacement	$ 84,518
Marine Employees	$ 734,773
Scranton Line	$ 450,000
Total	$11,238,621

(b) *Nonoperating Employees*

We base our calculations of the LPCs attributable to EL's nonoperating employees on the Shannon study, principally because the GPs' study did not specifically address this precise issue. Applying the methodology discussed above in the context of EL's operating employees, Shannon concluded that approximately 213 EL union nonoperating employees would have been terminated, 125 would have been relocated, and 310 EL nonunion nonoperating employees would have been terminated. Shannon (S) (Oct. 15, 1980) at 4 & 22. Based on an assumed level of benefits for union employees roughly equivalent to the *New Orleans* benefits, Shannon estimated that the LPCs resulting from these terminations would total $4.1 million. As in the case of operating employees, we must adjust Shannon's conclusions to reflect our disagreement with his assumed attrition and rehire rates.

Based on Shannon's workpapers, 999020-999043, EL App. N at 628-39, and testimony, Shannon (S) (Oct. 15, 1980) at 21-22, we estimate that the following numbers of EL nonoperating positions would have been eliminated in the years following acquisition:[165]

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Table 21

Positions Eliminated Following Acquisition

	MOW	*MOE*	*Trans.*	*Traff.*	*Gen.*	*Total*
Year 1	19	14	31	136	227	427
Year 2	19	14	31	136	228	428
Year 3	19	19	15	0	0	53
Year 4	6	0	0	0	0	6
Year 5	0	0	0	0	0	0

In determining the number of protected employees who would have been terminated, we must take into account the extent to which the above figures reflect terminations of unprotected employees. As discussed above, see p. 118, *supra*, nonunion employees occupying executive, professional, and supervisory positions would have been unprotected under the new agreements. Our examination of the "Erie Lackawanna Railway Company, Black Book", Shannon (D) (Feb. 12, 1981) Ex. 26, EL App. N at 583, convinces us that the figure used by Shannon for nonagreement employees is a fair estimate of the number of surplussed employees who would have been unprotected under the new agreements. Most noncontract employees fall within the categories noted above—and would have been unprotected under the new agreements. We reduce Shannon's figures only slightly, from 310 to 280, to reflect our rough estimates of the number of employees—such as secretarial and clerical employees—that likely would have been entitled to protection, see *id.*

Before applying attrition and rehire rates, we deduct the number of unprotected nonoperating employees from the total number of nonoperating position eliminated as a result of the proffered transactions (Table 21) to obtain the number of protected nonoperating positions that would be eliminated in the proffered transactions. For each year following acquisition, we deduct unprotected employees in numbers roughly proportional

to the total numbers of nonoperating position eliminated in each year:[166]

Table 22

Protected Position Eliminated

Year 1	427 − 126 = 301
Year 2	428 − 126 = 302
Year 3	53 − 28 = 25
Year 4	6 − 0 = 6

As with operating employees, attrition and rehire rates must be applied to these figures to obtain an estimate of the number of employees who would have had to be surplussed to achieve the savings reflected in EL's pro formas.

We accept as a reasonable estimate of the attrition rate for EL nonoperating employees the 13 percent figure used by Shannon. This figure was based on EL's historical attrition rate among nonoperating employees, Shannon (D) (Feb. 11, 1981) Ex. 16 at sheet 36, line 6, EL App. N at 552, and the GPs offered no particularized criticism of the rate. Shannon used a rehire rate of approximately 50 percent, see Shannon workpapers 999021, 999024, 999028, EL App. N at 629, 632, 636. We reject this figure, and adopt instead a rehire rate of 33 percent, for the reasons already discussed. Our application of attrition and rehire rates to the number of EL nonoperating employees potentially adversely affected by the acquisition (Table 22) follows:[167]

Table 23

Position Opened By Attrition

Year 1	1,194 x 13% = 155 + 75 = 230*
Year 2	767 x 13% = 100
Year 3	437 x 13% = 57
Year 4	412 x 13% = 54
Year 5	406 x 13% = 53
Year 6	406 x 13% = 53
Year 7	406 x 13% = 53

* Additional 75 position opened to reflect effect of pre-Day-1 attrition.

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Table 24

Rehires and Nondismissals

Year 1	230 x 33% = 76
Year 2	100 x 33% = 33
Year 3	57 x 33% = 19
Year 4	54 x 33% = 18
Year 5	53 x 33% = 18
Year 6	53 x 33% = 18
Year 7	53 x 33% = 18

Deducting the figures in Table 24 from the number of potentially adversely affected protected EL nonoperating employees (Table 22) provides the number of protected EL nonoperating employees who would have been eligible for labor protection:

Table 25

Dismissed Protected Employees

Year 1	301 - 76 = 225
Year 2	302 - 33 = 269
Year 3	25 - 19 = 6
Year 4	6 - 18 = (12)

We must next determine which of the eligible employees would have elected to receive a lump sum severance payment rather than monthly dismissal allowances. We adopt the same assumptions here that we used in the context of operating employee LPCs, see pp. 129-30, *supra*.

Table 26

Employees Electing Lump Sum Severance Payments

Year 1	225 x 40% = 90
Year 2	269 x 40% = 108
Year 3	6 x 40% = 2

The figures in Table 26 reflect the number of EL nonoperating employees that would choose to receive a lump sum payment. As

in the context of operating employees, we must consider the WJPA benefit formula (Table 8) and our estimate of the distribution of EL nonoperating employees by length of service to calculate the LPCs attributable to lump sum payments made to EL's nonoperating employees:[168]

Table 27

Cost of Lump Sum Payments

Year 1	2 x .25 x $12,419 =	$ 6,210
	4 x .5 x $12,419 =	$ 24,838
	6 x .75 x $12,419 =	$ 55,886
	78 x 1.0 x $12,419 =	$ 968,682
	Total	$1,055,616
Year 2	2 x .25 x $12,719 =	$ 6,360
	5 x .5 x $12,719 =	$ 31,798
	8 x .75 x $12,719 =	$ 76,314
	93 x 1.0 x $12,719 =	$1,182,867
	Total	$1,297,339
Year 3	2 x 1.0 x $13,022 =	$ 26,044
Grand Total		$2,379,000

It remains to calculate the LPCs attributable to paying monthly dismissal allowances to EL nonoperating employees:

Table 28

Employees Receiving Dismissal Allowances Per Year

Year		*1*	*2*	*3*	*4*	*5*	*6*	*7*
Employees	1	135	135	135	123*	105*	—**	—
Dismissed	2	—	161	161	161	161	143*	—**
in Year:	3	—	—	4	4	4	4*	—*

* Rehires, from Tables 24 & 25, deducted from earliest possible group. No rehires deducted from earlier years to avoid double-counting with Table 25.

** Benefits available for only five years.

As in the case of EL's operating employees, we reduce the dismissal allowances paid to employees by 50 percent, which we

think reflects the offset that may be attributed to outside earnings. We also reduce the fifth year of dismissal allowances paid to reflect the terms of the WJPA.

Table 29

Cost of Dismissal Allowances

Year 1	135 x $12,419 =	$ 1,676,565
Year 2	135 x $12,419 =	$ 1,676,565
	161 x $12,719 =	$ 2,047,759
Year 3	135 x $12,419 =	$ 1,676,565
	161 x $12,719 =	$ 2,047,759
	4 x $13,022 =	$ 52,088
Year 4	123 x $12,419 =	$ 1,527,537
	161 x $12,719 =	$ 2,047,759
	4 x $13,022 =	52,088
Year 5*	105 x 60% x $12,419 =	$ 782,397
	161 x 60% x $12,719 =	$ 1,228,655
	4 x 60% x $13,022 =	31,253
Year 6*	143 x 60% x $12,719 =	$ 1,091,290
	4 x 60% x $13,022 =	$ 31,253
Grand Total		$15,969,533
		50%
Total Cost of Monthly Dismissal Allowances		$ 7,984,767

* Only WJPA benefits available after expiration of four year period following acquisition.

(i.) *Fringe Benefits.* As in the context of operating employees we adopt a 17 percent figure as a reasonable estimate of the LPCs attributable to the payment of fringe benefits for EL non-operating employees receiving dismissal allowances:

Table 30

Cost of Fringe Benefits

17% x $15,969,533 = $2,714,820

(ii.) *Relocation Costs.* Application of a $5,000 average relocation cost per relocated employee and a 50 percent rate of relocation among rehired employees provides the following estimates of relocation costs:[169]

Table 31

Number of Rehires per Year

Year 1	76
Year 2	33
Year 3	19
Year 4	18
Year 5	18
Year 6	18
Year 7	4
Total	186

186 x 50% = 93 employees relocated

93 x $5,000 = $465,000 relocation costs

(iii.) *Displacement Costs.* Based on the assumptions discussed above, we calculate that LPCs attributable to the payment of displacement allowances to EL's nonoperating employees would have totalled approximately:

Table 32

Displacement Costs

1194 x 12% = 143 displaced employees

143 x $76.28 per displaced employee = $10,900

(iv.) *Total LPCs Attributable to EL's Nonoperating Employees.* Addition of the LPCs attributable to lump sum payments (Table 27), monthly dismissal allowances (Table 29), fringe

benefits (Table 30), relocation expenses (Table 31), and displacement expenses (Table 32) provides the following figure for total LPCs attributable to EL's nonoperating employees:

Table 33

Total LPCs Attributable to EL Nonoperating Employees

Lump Sum	$ 2,379,000
Dismissal	$ 7,984,767
Fringe Benefits	$ 2,714,820
Relocations	$ 465,000
Displacements	$ 10,900
Total	$13,554,487

Addition of the LPCs for operating and nonoperating EL employees produces an estimate of total EL LPCs of $24,793,108.

2. *Lehigh Valley*

We base our calculations of LV's LPCs on a study prepared by W. Arthur Grotz,[170] which we adjust to reflect our disagreement with various of the author's assumptions and choices of methodology. For the reasons discussed previously, see pp. 120-22, *supra*, we reject the GPs' study.

The starting point for Grotz's analysis was a manning study estimating the number of employees that would have been required to operate the LV system following acquisition. Grotz (S) (Oct. 15, 1980) at 15-16. Grotz estimated that 2,161 employees would be needed to run the LV system immediately following acquisition, *id.* at Table 2, and that 2,098 of these positions would be available for protected LV employees, *id.* Grotz concluded that 389 protected LV employees would be terminated as of the date of the acquisition, that 91 employees aged 64 or older would be terminated, and that 120 unprotected LV employees would be terminated, *id.* at Table 1. Grotz estimated

that an additional 116 employees would be terminated in the years following the acquisition.

We accept Grotz's conclusions regarding the number of employees that would have been terminated on "Day 1", the date of the proffered transaction. Grotz's conclusions were based on estimates of LV's future employment requirements—which we find to be reasonable. Grotz had considerable experience in the field of railway economics and was particularly well-informed regarding LV's system. Moreover, his study considered the effects of acquisition on each of the various categories of LV's workforce. We note also that Grotz's estimates of the numbers of adversely affected LV employees were larger than those of Kasher.[171]

Despite our agreement with Grotz's conclusions regarding Day 1 dismissals, we do not think an acquirer's management would have treated dismissals after Day 1 in the same fashion that Grotz's study did. In addition to the elimination of employment positions on Day 1, Grotz projected substantial reductions in the size of LV's workforce in the years following acquisition. Grotz concluded, however, that virtually no employees would be adversely affected as a result of these reductions in available positions on the LV system. Rather, Grotz implicitly assumed that all positions vacated through attrition in a given year could be permitted to remain open throughout that year in order to meet the reductions in employment projected for the next year, *id.* at Table 3. Thus, the number of positions opened by attrition was not reduced to reflect the fact that not all such positions could be filled with employees otherwise scheduled for dismissal, *id.* We think an acquirer would have adopted a less optimistic methodology in projecting its LPC liability under the new agreements. An acquirer's management would have recognized the serious obstacles to using attrition to reduce LPCs. In the words of the ICC, "practical limitations [such] as geography or personal qualifications would restrict the universal transfer and use of employees". *Pennslyvania R.R.—Merger—New York Central R.R.,*

327 I.C.C. 475, 689 (1966). A leading commentator in the field has observed that there is "no certainty that the skills or geographic locations of the employees who were expected to separate from the railroad would match the skills of the employees actually affected by the consolidation". Ables, *supra*, at 118. Likewise, discussing an almost identical issue, the Supreme Court has written:

> According to the findings of the hearing examiner in this case, 863 employees will be totally deprived of employment during the five-year period following the merger. Appellants argue that there is no need for these discharges since natural attrition will open up many more than 863 jobs during the same period. However, as the railroads point out, attrition does not work in a uniform or predictable manner and there is no indication that the elimination of surplus posts can be accompanied by the method appellants suggest. . . .

Maintenance of Way Employees v. *United States*, 366 U.S. 169, 178n.11 (1961).

We think these considerations, and a desire to avoid underestimating LPCs, would have prompted an acquirer's management to adopt a methodological approach to attrition similar to that we adopted earlier in calculating EL's LPCs. Only a portion of the positions vacated each year due to attrition would be considered available to reduce the number of dismissals projected for the following year: thus, a rehire or nondismissal rate would be applied to attrition-vacated positions to determine how many of these openings realistically could have been used to reduce the number of LV employees who would be terminated.[172]

We accept Grotz's use of a 12.53 percent attrition rate. This figure was derived by taking a weighted average of the historical rates of attrition for particular employee age groups that then were applied to the LV workforce, Grotz (S) (Oct. 15, 1980) at

23 & Table 4, and we see no basis for questioning Grotz's determination.

Although we applied a 33 percent rehire rate in calculating EL's LPCs, we adopt a 40 percent rate in LV's case. We think this, or an equivalent, adjustment would have been adopted by an acquirer to reflect the lesser impact of geographical limitations attributable to the smaller size of LV's system. Based on the assumptions and choices of methodology set forth above, we think an acquirer's calculations of the LPCs attributable to the LV system would have proceeded roughly along the following lines.

Based on Grotz's Tables 2 and 3, we estimate that the following numbers of protected positions would have been eliminated in the years following the proffered acquisition:[173]

Table 34

Protected Positions Eliminated Following Acquisition

4/76	389
10/76	112
10/77	206
10/78	133
10/79	100
10/80	0

These figures must be adjusted to obtain an estimate of the number of employees who actually would have been surplussed to achieve Grotz's forecast employment reductions:

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Table 35
Positions Vacated Through Attrition

4/76	2161 x 12.53%=271*
10/76	2015 x 12.53%=252
10/77	1809 x 12.53%=227
10/78	1676 x 12.53%=210
10/79	1576 x 12.53%=197
10/80	1576 x 12.53%=197
10/81	1576 x 12.53%=197

* Calculations reflect 12 months attrition to account for six months of pre-Day 1 attrition, assumed available to reduce Day 1 dismissals.

Table 36
Rehires and Nondismissals

4/76	271 x 40%=108
10/76	252 x 40%=101
10/77	227 x 40%= 91
10/78	210 x 40%= 84
10/79	197 x 40%= 79
10/80	197 x 40%= 79
10/81	197 x 40%= 79

Deducting the figures in Table 36 from the reductions projected in LV's available employment positions (Table 34) provides the number of protected LV employees who would be eligible for labor protection benefits under the new agreements:

Table 37
Protected Employees Dismissed

4/76	389—108=281
10/76	112—101= 11
10/77	206— 91=115
10/78	133— 84= 49
10/79	100— 79= 21

We must next determine which of the employees eligible for labor protection (Table 37) would have elected to receive a lump sum separation payment rather than a monthly dismissal allowance. We reject Grotz's use of a 50 percent figure representing the proportion of employees choosing lump sum separation payments, and adopt instead the 40 percent figure used in calculating EL's LPCs, see pp. 129-30, *supra*.

Table 38
Employees Electing Lump Sum Separation Payments

4/76	281 x 40%=112
10/76	11 x 40%= 4
10/77	115 x 40%= 46
10/78	49 x 40%= 20
10/79	21 x 40%= 8

We next consider the WJPA benefit formula (Table 10) and the distribution of LV employees by length of service, see Grotz (S) (Oct. 15, 1980) at Table 5, 8, to arrive at a figure for the LPCs attributable to lump sum payments to LV's employees:[174]

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Table 39
Lump Sum Payments

4/76	.25	x 2 x	$11,847	=	$	5,924
	.5	x 5 x	$11,847	=	$	29,618
	.75	x 8 x	$11,847	=	$	71,082
	1	x 97 x	$11,847	=	$	1,149,159
10/76	.75	x 1 x	$11,988	=	$	8,991
	.1	x 3 x	$11,988	=	$	35,964
10/77	.25	x 1 x	$12,276	=	$	3,069
	.5	x 2 x	$12,276	=	$	12,276
	.75	x 3 x	$12,276	=	$	27,621
	1	x 40 x	$12,276	=	$	491,040
10/78	.5	x 1 x	$12,571	=	$	6,286
	.75	x 1 x	$12,571	=	$	9,428
	1.0	x 18 x	$12,571	=	$	226,278
10/79	.75	x 1 x	$12,874	=	$	9,656
	1.0	x 7 x	$12,874	=	$	90,118
Total					$	2,176,510

The next step in our calculation of LV's LPCs requires computation of the cost of monthly dismissal allowances. We base our calculations upon the numbers of employees electing monthly dismissal allowances (derived from Tables 37 & 38) and the numbers of rehires per year (Table 36):

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Table 40

Employees Receiving Monthly Dismissal Allowances

	4/76	*10/76*	*10/77*	*10/78*	*10/79*	*4/80*	*10/80*	*4/81*	*10/81*
1	169	169	169	169	169	169	169	169	0*
2	—	7	7	7	7	7	0**	0	0
3	—	—	69	69	69	69	0**	0	0
4	—	—	—	29	29	29	26**	26	0**
5	—	—	—	—	13	13	13	13	0**

* Dismissal allowances limited to five years, see Table 41.

** 79 rehires in periods 10/80 and 10/81, from Table 36, assumed to come from earliest groups dismissed that are not receiving WJPA allowances.

Based on these figures, we calculate the LPCs attributable to payment of monthly dismissal allowances.

Table 41

Monthly Dismissal Allowances

4/76-10/76	169 x $11,847 x 50%	= $ 1,001,072
10/76-10/77	169 x $11,847	= $ 2,002,143
	7 x $11,988	= $ 83,916
Total		$ 2,086,059
10/77-10/78	169 x $11,847	= $ 2,002,143
	7 x $11,988	= $ 83,916
	69 x $12,276	= $ 847,044
Total		$ 2,933,103
10/78-10/79	169 x $11,847	= $ 2,002,143
	7 x $11,988	= $ 83,916
	69 x $12,276	= $ 847,044
	29 x $12,571	= $ 364,559
Total		$ 3,297,662

10/79-4/80	169 x $11,847 x 50% =	$ 1,001,072
	7 x $11,988 x 50% =	$ 41,958
	69 x $12,276 x 50% =	$ 423,522
	29 x $12,571 x 50% =	$ 182,280
	13 x $12,874 x 50% =	$ 83,681
Total		$ 1,732,513
4/80-10/80	169 x $11,847 x 50% x 60% =	$ 600,643
	7 x $11,988 x 50% x 60% =	$ 25,175
	69 x $12,276 x 50% x 60% =	$ 254,113
	29 x $12,571 x 50% x 60% =	$ 109,368
	13 x $12,874 x 50% x 60% =	$ 50,209
Total		$ 1,039,508
10/80-4/81	169 x $11,847 x 50% x 60% =	$ 600,643
	26 x $12,571 x 50% x 60% =	$ 98,054
	13 x $12,874 x 50% x 60% =	$ 50,209
Total		$ 748,906
4/81-10/81	26 x $12,571 x 50% x 60% =	$ 98,054
	13 x $12,874 x 50% x 60% =	$ 50,209
Total		$ 148,263
Grand Total		$12,987,086
Outside Earnings		x 50%
Total Dismissal Allowances		$ 6,493,543

In calculating fringe benefits we apply the 17 percent figure used in computing EL's LPCs and applied by Grotz in his study for LV:

Table 42

Fringe Benefits

17% x $12,987,086 = $2,207,805

Rather than assuming, as we did in EL's context, that 50 percent of all employees rehired would incur relocation expenses, we estimate that only 25 percent of the rehired LV employees

would be relocated. We think it likely that an acquirer would make such an assumption to reflect the smaller size of the LV system, and therefore the lesser likelihood of a need for relocation in particular cases. Application of this figure, and an average relocation cost of $5,000 per relocated employee yields the following results:

*Table 43**

Number of Rehires per Year

4/76	108
10/76	101
10/77	91
10/78	84
10/79	79
10/80	79
10/81	39
Total	581

581 x 25% (relocation rate) = 145.25 relocations

145.25 x $5,000 = $726,250 relocation cost

* Source: Tables 36 & 40.

Based on the assumptions discussed in calculating EL's LPCs, see pp. 139-40, *supra,* we estimate that LPCs attributable to the payment of displacement allowances to LV's employees would have totalled approximately:

Table 44

Displacement Costs

2,161 x 12% = 259

259 x $76.28 per displacement = $19,757

Addition of the LPCs attributable to lump sum payments (Table 39), monthly dismissal allowances (Table 41), fringe

benefits (Table 42), relocation expenses (Table 43), and displacement allowances (Table 44), provides the following estimate of LV's LPCs:

Table 45

Total LV LPCs

Lump Sum	$ 2,176,510
Dismissals	$ 6,493,543
Fringes	$ 2,207,805
Relocations	$ 726,250
Displacements	$ 19,757
Total LV LPCs	$11,623,865

3. The Effect of Bargaining and Other Factors on the Amount of the LPC Deductions

The preceding sections set forth what we believe a potential acquirer realistically would have calculated as its liability for EL's and LV's LPCs in the years following the proffered transactions. The acquirers, in negotiations with EL and LV, would have sought a deduction in purchase price for the Ts' properties based on these calculations. The Ts naturally would have resisted these attempts, arguing as they have in this case that LPCs attributable to their systems would have amounted to relatively little.

As noted previously, the acquirers would have made a conservative projection of their LPC liability. Our LPC calculations reflect this attitude, as three examples will illustrate. First, we did not consider the impact that attrition-created openings on an acquirer's lines would have on a T's LPCs. Some of these vacancies no doubt could have been filled by a T's surplussed employees, thus reducing LPCs. Second, our calculations did not attempt to account for measures taken by the Ts in the years preceding acquisition to reduce their workforces in an effort to minimize LPCs.[175] Third, we applied conservative 33 percent

and 40 percent rehire rates to attrition-created vacancies and to positions made available by rehabilitation and capital improvement programs to determine the extent to which these could be used to reduce the number of dismissals, as well as to permit the rehiring of dismissed employees.

Although we are convinced that the assumptions and methodologies we have adopted, or equivalent ones, would have been used by an acquirer, we also recognize that bargaining would likely reduce the size of the LPC reductions, in part because the T could argue that the acquirer's LPC projections were unduly conservative. Two other considerations, however, would have been even more significant in reducing the size of the LPC deduction. First, labor protection payments made by an acquirer to the Ts' former employees would have been deductible by the acquirer for tax purposes. This would have reduced both the actual cost to the acquirer of the labor protection payments and the size of the LPC deduction by 50 percent. Second, because the acquirer would have been receiving a lump sum LPC deduction from the purchase price, we must calculate the present value—as of the date of agreement on the price of the T's lines—of the acquirer's projected after-tax labor protection payments. As developed in Part VII, we use a 9.13 percent discount rate. Application of this rate to the after-tax LPCs attributable to EL and LV employees produces a deduction of $8,320,737 from the EL purchase price and a $3,929,441 deduction from the LV purchase price.

These figures represent the approximate size of the LPC deduction from the purchase prices for EL's and LV's properties. Competitive bidding and the willingness of the potential acquirers to make some adjustments in the size of the LPC deduction to reflect the possibility that their LPC calculations were unduly pessimistic might have reduced the figures slightly, to $8,300,000 and $3,900,000. The acquirers would not have been likely to agree to further reductions, because of their fears that LPCs would exceed even their pessimistic projections, as had occurred in other situations.[176] We do not assert that these estimates are

exact. The unpredictable nature of the bargaining process and the uncertainty surrounding attempts to predict labor protection costs would frustrate any such effort. We are satisfied, however, that our estimates reasonably approximate the outcome of negotiations among EL, LV, and the acquirers.

4. *Ann Arbor*

AA contends that it would have incurred no LPCs in the alternative scenario because all its properties would have been acquired by the State of Michigan or private purchasers, and reductions in AA's workforce therefore would have been minimal or nonexistent. AA at 183-84. The GPs argue that, even assuming such an acquisition, the prices paid for AA's lines would reflect a LPC deduction. The GPs reason that the State of Michigan would pay only slightly more for AA's northern properties than AA's "next best marketplace alternative". This alternative, the GPs correctly point out, would have been abandonment. Accordingly, the GPs conclude, the LPCs that would result from this abandonment would be deducted from the purchase price for the northern properties. AA responds that neither existing labor protection agreements—principally the WJPA—nor ICC decisions provide a basis for concluding that it would have incurred labor protection obligations had it pursued its next best marketplace alternative. Because of the unusual context in which disputes regarding these agreements and decisions would have occurred—negotiations between the State of Michigan and AA regarding a purchase price for AA's properties—we address separately AA's contentions regarding these issues.

Earlier in this Part we concluded that substantial uncertainty would have surrounded the question whether the WJPA was applicable to the proffered transactions. We think, for the reasons noted above, that similar uncertainty would have characterized negotiations between the State of Michigan and AA. We

also concluded that the ICC's line of *Okmulgee* decisions likely would have been considered distinguishable from the circumstances of the alternative scenario. AA, however, had less trackage (185.4 miles total; 131.2 miles to be abandoned) than some of the railroads involved in the *Okmulgee* cases. For example, the Tennessee Central was 287 miles long, and the Rutland was 332 miles long. Moreover, the relatively isolated and small-scale dismissals that such an abandonment would entail would not have presented a particularly compelling case for ICC insistence that AA proceed under §5(2).

Nonetheless, the State of Michigan could have pointed to a number of ICC precedents which strongly suggest that some sort of labor protection conditions would have been applied had AA pursued its next best marketplace alternative. As the GPs note, in circumstances where an abandonment—even of an entire line—is closely linked to financial gain to the controlling interests of a railroad, the ICC has imposed labor protection conditions pursuant to §1(18) of the Interstate Commerce Act. *E.g., Washington & Old Dominion R.R.—Abandonment of Entire Line,* 331 I.C.C. 587, 600-02 (1968); *Seaboard Air Line R.R. Trackage Rights—Atlantic Coast Line R.R.,* 324 I.C.C. 506, 520-22 (1964); *East Caroline Ry. Abandonment of Entire Line,* 324 I.C.C. 506, 520-22 (1964). This line of decisions—which is at times difficult to reconcile with the *Okmulgee* decisions—would have provided a basis for the State of Michigan to argue that AA would have been saddled with labor protection obligations in the next best marketplace alternative scenario. Moreover, the State of Michigan could have argued that the private acquirer of AA's Toledo-Ann Arbor segment might well have conditioned its purchase on AA's proceeding under §5(2)—in order to receive the antitrust immunity conferred by §5(11). Lastly, we think that the State of Michigan could have argued persuasively that labor unions, through the threat of

strikes and unrest, could have obtained some sort of labor protection commitments from either AA or the acquirers, even without relying on existing agreements or ICC actions.

These considerations indicate that some LPCs would have been incurred in AA's next best marketplace alternative scenario. The labor protection payments likely would have been made by the acquirer of AA's Toledo-Ann Arbor segment. The acquirer would have been willing to assume the obligation for LPCs, in return for a deduction from the purchase price for AA's southern properties, in order to minimize the risk of labor unrest on the acquired southern lines. Moreover, the acquirer would have recognized that the ICC might require that it bear responsibility for labor protection payments. This outcome is suggested by ICC decisions under §1(18) in which carriers absorbing an abandoning carrier's lines were required to make labor protection payments to the abandoning carrier's employees. See *East Caroline Ry., supra,* 331 I.C.C. at 507; *Seaboard Air Line R.R., supra,* 324 I.C.C. at 800-01.

The above considerations would have provided the State of Michigan with substantial leverage in negotiations with AA regarding a purchase price for its northern properties. AA's only bargaining power would have derived from a threat to abandon its northern segment. Actual abandonment, however, would have required AA to risk the ICC's imposition of labor protection obligations or the labor union's successful enforcement of existing labor protection agreements. Moreover, it could have resulted in labor unrest that would have jeopardized the rail use sale of the Ann Arbor-Toledo line. We think it unlikely that AA would have been willing to engage in such brinksmanship. Rather, it would have stayed at the bargaining table arguing for a reduction in the size of the State of Michigan's LPC deduction. The threat of abandonment would have been a relatively weak bargaining tactic in these circumstances.

The GPs contend that AA's LPCs would have totalled $2,197,000 if the ICC had imposed *New Orleans* conditions,

Kasher (S) (Nov. 1, 1979) at 50 and $1,374,000 if the WJPA had applied, *id.* at 51. The estimates assume that AA's lines would have been acquired in mid-1974, and that labor protection obligations would have extended from that date until mid-1978 and mid-1979 respectively. Figures in this neighborhood would have provided the starting point for negotiations between AA and the State of Michigan. Because we have concluded that AA's bargaining position would have been inferior to that of the State, we think AA would have been unable to obtain any significant concession from the State's LPC calculations. We do think, however, that the uncertainty surrounding the likely outcome of ICC action in the next best marketplace alternative scenario would have resulted in some concessions by the State, ultimately leading to a compromise agreement basing estimates of LPCs on the WJPA, rather than the *New Orleans*, level of benefits. This conclusion is also supported by the fact that the GP's calculations of AA's LPCs assumed a mid-1974 disposition, while bargaining between AA and the State of Michigan would have assumed an April 1, 1976, acquisition. A later acquisition date would have permitted AA to take measures to minimize LPCs. Accordingly, the $1,190,000 figure cited above would have provided the basis for the LPC deduction for AA's northern lines.

As in the case of EL and LV, this figure would have been reduced by 50 percent to reflect the deduction of labor protection payments for tax purposes. This conclusion follows from the fact that, in the next best marketplace alternative scenario, the acquirer of AA's southern segment would have assumed responsibility for AA's LPCs in return for a LPC deduction from the purchase price for the southern segment. As in the case of EL and LV, the acquirer could have deducted its future labor protection payments for tax purposes. This would have reduced the LPC deduction the acquirer could have obtained from AA, thus increasing the amount AA could realize in the next best marketplace alternative scenario—and the amount the State of Michigan would be required to pay for AA's properties.

This figure also must be discounted to present value as of January 1, 1974. As we have elsewhere, p. 163, *supra*, we use a 9.13 percent discount rate, which we apply to the annual after-tax LPCs reflected in the GPs study. Kasher (S) (Nov. 1, 1979) at 51. Although these figures may be somewhat overstated as regards AA's LPCs under the WJPA, because they assume a mid-1974 acquisition date, we think they are adequate as regards AA's LPCs in a 1976 acquisition under the *New Orleans* conditions. We calculate that bargaining between AA and the State of Michigan would have resulted in an agreement that the present value of AA's LPCs as of January 1, 1974, would have been $493,200.

5. *Lehigh & New England*

As discussed below, we conclude that L&NE's system would have been sold for no more than X. Accordingly, as we have noted earlier, L&NE would incur no labor protection expenses. This conclusion follows from the fact that L&NE could scrap its lines completely and thus incur no labor protection obligations.[177] Thus, an acquirer would be obliged to offer L&NE at least the scrap value of its lines and to agree to hold L&NE harmless from labor protection expenses to prevent it from actually abandoning.

X. Timing and ICC Conditions

The element of timing is perhaps this opinion's most "prodigious and time-consuming effort in conjecture", *CMV Opinion*, 445 F.Supp. at 1045. It is nevertheless important for several reasons. Delay of a sale much after 1974 would decrease the chance that a prospective purchaser would look only to 1973 as the base year for calculating the earnings value of a given line. Because traffic levels, and hence revenues, declined sharply over all the Ts' lines after 1973, this would have resulted in earnings values significantly lower than ones based exclusively on 1973 data. See pp. 261-62, *infra*. Continuing physical deterioration

of the Ts' rail properties during such delay would have increased necessary rehabilitation costs, which also would have been taken into account by an acquirer. Timing also bears on the amount of labor protection that would have been necessary. See pp. 163 & n.175, *infra*. For these issues, a rough estimate on timing might suffice. But the Ts are entitled to interim interest on any sums they could have realized earlier than April 1, 1976, the date their rail properties were conveyed to Conrail; conversely, the proceeds from a disposition after that date must be discounted back to that date. It is therefore necessary for us to find a precise date by which each T's hypothetical sales probably would have been completed.

We have no illusions about the rigor with which such an inquiry can be conducted. Although the GPs attempt to analyze the stages of the disposition process in grater detail than do the Ts, the parties agree that it would be futile to attempt to write a detailed "history" of the disposition process. See, *e.g.*, 6 GP at Z 9-10; ELRB at 6-7. At best, it is possible only to render a cumulative judgment on how long each broad phase of the disposition process would have been likely to take. As with several other points in this opinion, resolution of the timing issue requires not a "yes-no" judgment of the sort called for in cases requiring determination of historical fact, but rather a choice of one among a number of plausible outcomes. The conventional concept of burden of proof has little meaning in such circumstances. Any particular choice can, in truth, be little more than in impartial guess based upon the evidence and the argument.

We tentatively considered the timing issue in the *CUE Opinion*, 439 F.Supp. 1351, when evaluating the Ts' entitlement to compensation for erosion of their estates due to the compelled continuation of operations at a loss before the conveyance date, April 1, 1976. We held there that such erosion cannot be laid at the government's door unless a T can show that, but for the Rail Act, it would have sought and should have obtained ICC approval to sell or abandon its rail properties before the conveyance date.

The issue of timing therefore became decisive on that of compensable erosion. We stated that the Ts' "burden of demonstrating the probability of obtaining a final decision on and consummating major abandonments or sales before April 1, 1976 . . . will be extremely heavy", 439 F.Supp. at 1375, but left it open for each T to try to do so. 439 F.Supp. at 1374-75, 1379-80. The evidence presented in this phase of the case generally confirms that preliminary judgment. We find that all the Ts' proposed sales and abandonments[178] probably would have been completed on, but not before, April 1, 1976.

A. *The Parties' Positions*

Except for CNJ, whose unique timing arguments we consider and reject at pp. 305-09, *infra*, the various Ts' contentions about the disposition process are consistent with each other. Indeed, the GPs and the Ts do not seriously disagree about the basic steps of the disposition process, at least when those steps are stated in sufficiently general terms. See 6 GP at T 28-29. Each T, including PC and R before their dismissal from the case, claims that it would have sought to dispose of its rail properties as the first of two steps[179] in a plan of reorganization under §§ 77(d) and (e) of the Bankruptcy Act.[180] Those provisions require such a plan to have the approval of both the ICC and the reorganization court.[181] The Ts and the GPs envision each T's disposition process as taking place in three broad phases.

Commencing with each estate's determination to liquidate its rail properties, the first phase would have encompassed the reaching of sale agreements. Each T would have announced a program to dispose of its rail properties by either sale or abandonment and would have solicited expressions of interest from solvent railroads and public bodies. Each potential purchaser would have had to study the costs and benefits of the various possible acquisitions before serious negotiations could take place. Some negotiations would have been complicated by

the need for several interested parties to negotiate with each other simultaneously. For example, no solvent railroad would have purchased any T's lines until it had reached an accommodation with that T's unions over labor protection. Some negotiations would have been wholly contingent on others, as in the case of AA's contention that the potential acquirers of PC's Chicago-Detroit or Detroit-Cincinnati IFLs would have bid for its Toledo-Ann Arbor segment. See AA at 31. Even after the main contours of the reconfigured rail system in the Northeast began to emerge, traffic and revenue projections for many freight lines would have depended in part on the terms on which freight traffic would have had access to connecting lines slated for acquisition by public bodies; similarly, public bodies acquiring parts of the NEC would have had to agree among themselves on how to allocate the costs of intercity passenger service. While these studies and negotiations were taking place, each T would have instituted formal proceedings before the ICC to lay the groundwork for approval of the transactions; they would have filed applications to abandon or sell their entire rail systems at the beginning of the process, submitted to the ICC the data that were being made available to prospective purchasers, and filed applications for approval of specific sales as each was negotiated. At the same time, the ICC would have begun an investigation on its own initiative to develop detailed information about the transportation needs of the Northeast for use in those proceedings.

The parties are in apparent agreement that this first phase of the process, however long it would have taken, would have resolved the question of price. Conceivably, the parties to a sale might have reached only an agreement to agree later on a price, but this is unlikely. None of the parties makes this argument, and the briefs apparently assume that the Ts and their acquirers would have agreed on a price before seeking ICC approval. See, *e.g.*, 6 GP at T 28. In addition, some of the witnesses thought the negotiation phase would resolve the question of price. Whitehurst (S) (Nov. 1, 1979) at 39; Hesse (S) (R Pro' able Actions)

(Dec. 31, 1978) at 18-20. Finally, the ICC, at least to the extent it was proceeding under § 5 of the Interstate Commerce Act, would not have considered an application that did not include a price term. 49 C.F.R. § 1111.1 (c)(2) (1974).

The second phase, partly overlapping the first, would have consisted of the ICC's deliberations over the sales and abandonments. As we discussed in Part IX, *supra,* sales would have been evaluated under § 5(2) of the Interstate Commerce Act; abandonments would have been evaluated under § 1(18).[182] In parallel with these deliberations, the ICC would have conducted any further inquiries into the Ts' financial condition required by the Bankruptcy Act. After giving its approval to the sale and abandonment applications, along with any conditions it saw fit to attach, it would have certified the Ts' plans of reorganization, as modified, to their respective reorganization courts.

The final phase of the disposition process would have encompassed any steps necessary to complete the dispositions after the ICC approved them. At a minimum, § 77(e) of the Bankruptcy Act would have required each estate's reorganization court to hold a hearing on and give its approval to the estate's proposed dispositions. Further time would have been necessary for the Ts and the acquirers to negotiate any changes made necessary by ICC modifications of the proposals as initially submitted and to formalize the sale agreements, and for the acquirers to finalize credit arrangements.

In addition to agreement on the broad steps of the disposition process, there is now no dispute as to when each T would have begun to dispose of its properties. This issue was settled by paragraph 10 of the Second Pre-Trial Order, which provided that "the transferors (including the Trustees of the Erie Lackawanna) are entitled to assume that, in the absence of the Rail Act, serious consideration and discussion of dispositions for continued rail use would have begun not later than February, 1973". Thus, even though EL did not lose hope of achieving an income-based reorganization until January 1975 in the real world, it now believes,

with the other parties, that it would have filed for authority to sell or abandon its freight lines in mid-February 1973 in the alternative scenario. EL assumes that PC would have filed for abandonment in February 1973, and that EL's management then would have realized that Western carriers would have been prompted to purchase PC's IFLs, thereby threatening to divert traffic from EL and dashing its hopes for a successful reorganization. 1 ELF at 19-20. LV, which actually filed a petition for abandonment with its reorganization court in early March 1973, contends that it would have filed at least as soon in the alternative scenario, LV at 20; R would have followed suit sometime in the spring of 1973, 2 RF at 214-15; and AA, which had had an application to abandon its car ferry operations across Lake Michigan pending since 1972, would have applied to the ICC for permission to sell or abandon its rail properties not later than May 1974. AA at 6, 28 n.l.

Although the general framework and the starting point of the disposition process are thus not in dispute, the parties' disagreements over how long each phase of the process would have taken lead to sharp differences at the bottom line. The GPs offer relatively detailed testimony on each phase of the disposition process. Several experts analyzed the time required for potential purchasers to study the proffered lines and for the basic terms of purchase to be negotiated.[183] Others addressed the difficulties involved in the multi-sided negotiations that would have had to take place among the Ts, solvent buyers, and labor;[184] among various Ts, solvent buyers, and public bodies over who would acquire the commuter lines and other lines in the JT areas, and over the switching and trackage fees to be levied by public bodies that acquired such lines; and among the various public bodies that would have acquired segments of the NEC spine.[185] Still others addressed the various tasks the ICC would have had to perform, and the steps necessary to consummate the transactions after ICC approval.[186]

Relying partly on analogies to past sale and abandonment transactions and partly on ad hoc judgments about the transactions involved here, those experts concluded that at least three-and-one-half to four years would have been necessary for potential buyers and labor to complete necessary studies and reach agreement with the transferors, see 6 GP at T50-52, 58-64, 94-96; that at least four-and-one-half to five years would have been necessary to obtain ICC approval for the transactions, see *id.* at T 104; and that at least eight months would have been necessary to complete the transactions after final ICC action, see 6 GP at T 147-52. Assuming that PC began its disposition process in February 1973, these figures would point to a completion date no sooner than October 1981. The GPs choose to err on the side of generosity and argue for a completion date no sooner than late 1978 or early 1979.

Underlying the GPs' timing case are three vital premises. First, the GPs contend that the federal government would have been willing to provide to the Ts for an indefinitely long period whatever aid was necessary to prevent them from shutting down for want of cash. Second, they contend that Congress would neither have imposed time limits on the ICC's deliberations nor have altered the ICC's substantive legal mandate for the occasion. Finally, the GPs contend that the ICC would not have considered each T's sale and abandonment applications in isolation, but rather would have consolidated all the proceedings in order to evaluate the effect of each proposed transaction on the others and on the region as a whole. The effect of this last contention is to slow each disposition process at least to the pace of the slowest T, which, because of its size and complexity, inevitably would have been PC.

The Ts' timing cases (including that of PC, whose timing evidence the Ts remaining in the case generally adopt) rest on the negation of these three premises.[187] Their primary argument is that Congress would not have provided them with any financial aid, and that their dispositions therefore would have to have been

completed before they ran out of cash and had to cease operations. Content to argue that because potential buyers, labor, and the ICC could not tolerate a shutdown, they would have found some way to complete the transactions before the Ts became cashless, the Ts eschew discussion of supposedly analogous historical transactions, and they offer little testimony about the details of each phase of the disposition process. Under this theory, PC, LV, and R equate their disposition dates roughly with the date by which each would have run out of cash: July 1974, March 1974, and mid—1974, respectively.[188] AA, rather differently from the others, claims that it would have become cashless in May 1974, but does not deny that it would have received interim aid from either the state or federal government; rather, it contends that it could have completed its dispositions by the spring of 1975 because all of its potential acquirers were familiar with its operations and hence would have needed little time to formulate a bid, and because none of its dispositions would have been opposed before the ICC. EL, true to its theory that its disposition process would have paralleled that of PC, links its disposition date to PC's. PC and EL thus project completion of their disposition processes roughly eighteen months after their determination to liquidate; the others project even faster dispositions. Partly in support of their cashlessness argument and partly as a fallback, the Ts argue that Congress would have imposed a deadline on the ICC's deliberations or drastically changed its legal mandate. Failing that, they argue, the reorganization courts would have imposed deadlines on the ICC. Finally, several Ts deny that the ICC would have consolidated their applications with those of PC or other Ts.

Appendix H

B. *Analysis*

1. Likely Congressional Initiatives in the Alternative Scenario

The most serious source of uncertainty in any inquiry into the disposition process lies in estimating the likely behavior of Congress in the alternative scenario. We specifically opened the door to argument on this issue in the *CMV Opinion*, 445 F.Supp. at 1008-09, and suggested that Congress might have provided "interim financial aid" to the Ts or enacted "regulatory reforms". The GPs and the Ts both contend that Congress would have undertaken special initiatives shortly after the Ts began their liquidation programs, but they focus on different halves of this suggestion. The GPs posit an open-ended program of operating subsidies designed to keep the Ts afloat during an indefinitely prolonged disposition process. At the same time, they reject any argument that Congress would have attempted to shorten the process by imposing a deadline for ICC action or by changing its mandate. The Ts' position is the opposite of the GPs': they contend that Congress would have granted them no interim aid, but would have placed time limits and other constraints on the ICC's deliberations. Their argument against interim aid implicitly depends on a single premise: that Congress would have realized that the Ts' dispositions could be completed speedily if the potential acquirers, interested third parties, and the ICC were all forced to meet the deadline imposed by the Ts' imminent shutdown for want of cash.

The Ts make a plausible case that extremely fast dispositions, on the order of eighteen months, might have been feasible if Congress had been absolutely determined to force such an outcome. Nevertheless, we think it almost certain that Congress would have chosen to lengthen the disposition process to some extent, and therefore would have provided some form of emergency aid to the Ts. The Ts do not deny that Congress' primary motive in the alternative scenario would have been to maximize

the likelihood that the Ts' lines would remain in rail use. See 2 RF at 255-57. According to the premise laid down in the *CMV Opinion*, 445 F.Supp. at 1005, we must assume that Congress would not have ensured that outcome by acquiring the lines for the federal government; hence that motive would have manifested itself by actions designed to maximize the chance that sales such as those the Ts propose would be consummated. But Congress would have seen that the speedy disposition schedule the Ts propose could backfire, for, as the GPs' evidence shows, potential bidders, particularly solvent railroads, might simply have refused to bid at all if they were not given enough time to perform the studies necessary to form a rational judgment about the value of the Ts' lines. See 6 GP at T 177. The Ts' evidence does not rebut this; it purports to show only that potential bidders could have met the Ts' schedule if forced to do so. That evidence does not bear on whether Congress would have risked that experiment. In deciding whether more time than the eighteen months allowed by the Ts would have improved the likelihood of substantial rail use sales, Congress would have been entitled to look to prior sale and abandonment transactions. The Ts, however, cite no transaction that was anywhere near the size and complexity of the ones PC alone would have undertaken and was completed in anywhere near the eighteen months they postulate, and the GP's survey of prior transactions demonstrates that much simpler transactions commonly took far longer. See 6 GP at T 152. Congress could hardly have escaped the conclusion that more time would have substantially helped the chances for a successful disposition.

Apart from the objective reasonableness of providing for a longer disposition process, we are persuaded that it would have been inevitable as a matter of political reality. Representative members of most affected interest groups—shippers, labor, and state and local governments—testified persuasively and without effective contradiction that they would have demanded that Congress provide enough interim aid to allow for a disposition process long enough for them to sort out their options and organize an

effective defense of their interest before the ICC. See 6 GP at T 167-172.[189] Such efforts could not have been effective until the Ts' sale and abandonment plans were completely negotiated and set out before the ICC. If, as we find below, that would take a minimum of a year, then at most six months of the Ts' eighteen-month schedule would remain for ICC proceedings. Even if the ICC could have met its statutory obligation to afford a "reasonable opportunity for interested parties to be heard", Interstate Commerce Act § 5(2)(b), 49 U.S.C. § 11344, in that period, which we doubt, these constituent group would have argued to Congress, with much justice, that the ICC could be little more than a rubber stamp for the Ts' proposals in such a condensed proceeding. With virtually every constituent group but the Ts themselves clamoring for more time to prepare their cases, Congress would inevitably have responded. For the same reason, while some of the Ts suggest that Congress would have curtailed the ICC's role in the disposition process or eliminated the right of third parties to be heard, we agree with the GPs' experts that such a move would have been politically unlikely. This is the price the creditors of the Ts' estates would have paid for living in a democracy. *See CUE Opinion,* 439 F.Supp. at 1373. We therefore find that Congress would have allowed more time for the disposition process than the eighteen months for which the Ts argue, and hence would have provided the Ts with at least some interim financing.

On the other hand, we also reject the GPs' contention that Congress would have provided such aid without limit as to time or amount. Congress would have had to announce a deadline on interim aid if it wanted sales to be negotiated at all. To show this, it is necessary to note only that some of the sales would be of admittedly losing operations to public bodies, and that none of the sales could take place without the acquiescence of labor unions. Common sense and the GPs' own evidence both indicate that neither labor nor public bodies would have agreed to do those things unless and until faced with the even worse prospect of

imminent shutdown. The GPs suggest no reasons why these actors would not have been content simply to put off the evil day as long as the federal government was willing to subsidize continued operations.[190] Under the principles stated in the *CUE Opinion*, however, the government could constitutionally have forced the Ts to continue their hopelessly losing rail operations, while their estates continued to erode, only if the government could show a certainty or a high likelihood that the erosion would cease within a reasonable time.[191] We have grave doubts whether it could have made that showing before the Ts' reorganization courts if it had followed the course the GPs suggest.

We need not go so far as to hold that a reorganization court would have been justified in granting a T immediate permission to shut down. It is enough to say that Congress would have been aware that the indefinite continuation of interim aid would have created a danger of triggering a court-ordered shutdown. See *CUE Opinion*, 439 F.Supp. at 1377-78.[192] But Congress was acutely sensitive to that danger in the real world, see *id.* at 1361; Northeast and Midwest Railroad Transportation Crisis: Hearings Before the Subcommittee on Surface Transportation on S. 2188, 93d Cong., 1st Sess. 886-87 (1973) (comment of Mr. Adams), and, as the GPs' own evidence shows, preservation of essential rail service would have been its overriding priority. Clausen (S) (Nov. 1, 1979) at 3-4. Hence, we are certain that it would have avoided that danger by announcing, in advance, a date in the reasonably near future after which it would cease to subsidize the Ts, thereby forcing all necessary actors to agree by that date. In effect, Congress would have been forced to write the sort of "essay in brinksmanship" we condemned on the part of the Ts in the *CUE Opinion*, 439 F.Supp. at 1379.[193]

Apart from fears of a court-ordered shutdown, Congress would have had more mundane reasons to place a deadline on the negotiation process. The GPs' thesis requires us to believe that Congress would have knowingly opened the federal treasury to a drain of unknown but very substantial size for an indefinite period,

ceding all control over the duration of the subsidy to any necessary actor that chose to be intrasingent, and without any assurance of a desirable result.

The record supports our conclusions. Aage Clausen, the GPs' main witness on congressional actions in the alternative scenario,[194] correctly stated that "[e]vidence of prior Congressional action is the best predictor of how Congress would have acted in the period under consideration". Clausen (S) (Nov. 1, 1979) at 9. Of the rail legislation analyzed by Clausen, however, none committed the federal government to provide substantial aid to privately owned railroads without retaining strict control over its amount, duration, and use. None is remotely like the open-ended commitment to underwrite operating deficits that the GPs' thesis requires.[195] To be sure, Congress would have needed to give potential acquirers enough time for study so that they could submit rational bids, since they might otherwise have balked at bidding at all. It would also have needed to allow some time for the voluminous details of the transactions to be negotiated. But there is no evidence, and no reason to believe without evidence, that any time beyond this bare minimum would have made sales for rail use any more likely. Hence there would have been no reason for Congress to spend substantial amounts of taxpayers' money on subsidies for any longer period.

For similar reasons, we are persuaded that Congress would have placed a time limit on the ICC's deliberations. The fact that Congress placed a deadline on the USRA's creation of the Final System Plan in the real world is a strong indication of that, for while the USRA formulated its plan, Congress was providing much the sort of subsidy that would have been necessary in the alternative scenario. Congress would probably have seen it as far less expensive to hasten the ICC's deliberations by expanding its staff for the occasion, concentrating the same resources that in the real world went into the creation of the USRA and the ICC's Rail Services Planning Office, and expansion of the Department

of Transportation, than to pay operating subsidies to the Ts for an extended period.

Even aside from its wish to protect the public purse, we doubt that Congress would have relied on the ICC's normal procedures without giving it some kind of prod. Congress showed its mistrust of those procedures at the time of the rail crisis and on many occasions thereafter. Its rejection of the ICC's proposed solution to the rail crisis and creation of an entirely new agency to draw up the Final System Plan were partly due to the mistrust engendered by the Commission's traditional delays.[196] At the same time that it provided interim aid, Congress would have set time limits on the ICC's deliberations. Congress repeatedly passed legislation imposing deadlines on the ICC's handling of sale and abandonment applications relatively soon after the Rail Act, as discussed in detail below. The first such deadline, enacted in the Railroad Revitalization and Regulatory Reform Act of 1976, was proximately inspired by the ICC's unusual delays in handling the Penn Central and Rock Island merger applications. See Corber (D) (July 7, 1980) at 128-30, EL App. K at 198-200; S. Rep. No. 499, 94th Cong., 2d Sess. 19, *reprinted in* [1976] U.S. Code Cong. & Ad. News 14, 33. But the Penn Central merger had been completed and the Rock Island had already dragged on for ten years by 1973. Thus there is no reason to expect that Congress' actions in the alternative scenario would not have been guided by the same inspiration. GP witness Robert Corber, formerly a Commissioner of the ICC, admitted that Congress "would have urged the Commission to promptly dispose of the applications in the proceedings that were before it". Corber (D) (July 7, 1980) at 137, 8 RF App. at Ex. 77. Given its record of placing deadlines when it considered speed important, we cannot believe that it would have relied on moral suasion alone.

The GPs advance little evidence to the contrary. Virtually all of their experts assume that we ruled out the possibility of such legislation. See, *e.g.*, Corber (D) (July 7, 1980) at 80-82, EL App. K at 195-196; Brooks (D) (July 14, 1980) at 74-75, EL

App. K at 214-215. In fact, in the *CMV Opinion*, 445 F.Supp. at 1008-09, we explicitly ruled it in.[197] Although some witnesses testified, and we have held, that pressure from shippers, labor, localities, and other interested parties would have prevented Congress from cutting off their right to participate in ICC proceedings or from making drastic changes in its substantive mandate, see 6 GP at T 168-72, this factor does not proscribe time limits. Indeed, those same pressures did not prevent Congress from passing the ICC reform legislation we noted above. As the ICC's experience under those reform statutes shows, its procedures could have been expedited considerably without drastic changes in its mandate. For example, although interested parties have a statutory right to submit evidence and argument in sale and abandonment proceedings, the GPs concede that they have no statutory right to submit it orally. See 6 GP at T 122. The ICC could have limited or dispensed with hearings, as it already did for certain classes of cases, see Brooks (D) (July 14, 1980) at 164, 7 RF App. Ex. 71, and it could have placed a time limit on submission of written evidence and argument, see Milwaukee Road Abandonment Proc., 44 Fed. Reg. 50975. Similarly, it could have dispensed with initial hearings before an administrative law judge. See Brooks (S) (Nov. 1, 1979) at 16. Preparation of an environmental impact statement as required by the National Environmental Policy Act (NEPA) could have been a lengthy process. Congress, however, granted exemptions from NEPA in the Rail Act and in two ICC reform statutes aimed specifically at expediting deliberations over sales and abandonments proposed by railroads in reorganization. Milwaukee Railroad Restructuring Act, § 19, 45 U.S.C. § 917; Rock Island Railroad Transition and Employee Assistance Act, § 113, 45 U.S.C. § 1010. These statutes, combined with Congress' frequent practice of granting NEPA exemptions when time is of the essence and to particularly complex transactions, see, *e.g.*, Trans-Alaska Pipeline Authorization Act, 43 U.S.C. § 1652(d); Alaska Natural Gas Transportation Act, 15 U.S.C. § 719(h)(c)(3), convince us that a similar

exemption would have been provided here, especially since continuation of rail service rather than its abandonment and replacement by trucks and buses was obviously in the interest of the environment.

The principles that would have guided Congress are thus relatively clear. Estimating the numbers it would have chosen is more difficult. With respect to the time limit it would have placed on the ICC, the deadline imposed on USRA in formulating the Final System Plan is highly pertinent, for USRA dealt with the same properties that would have been before the ICC. That deadline was originally fifteen months, later extended to nineteen months because of delay by President Nixon in appointing the Board of USRA, see *CUE Opinion,* 439 F.Supp. at 1363. See Rail Act § 207(c). That extension would not have been necessary in the alternative scenario.

We stressed in the *CUE Opinion,* 439 F.Supp. at 1373-74, 1375, differences between the task that actually faced USRA and the one that would have faced the ICC. See also *180-Day Appeals,* 384 F.Supp. at 922. While they are undoubtedly substantial, on further reflection they are not so great as we there portrayed them. Indeed, in one important respect the ICC's task would have been the simpler one: a basic outline of what rail lines would stay in rail use and who would own them would have been presented to it as a product of negotiations. By contrast, USRA had to design a rail system for the Northeast from scratch. It had not only to decide what would stay in rail use and what would not, but also who would own what lines; it had to negotiate with solvent railroads to persuade them to acquire lines, see 3 GP at I 28-34; and it pondered alternative structures for Conrail itself, *180-Day Appeals*, 384 F.Supp. at 958 n.73. It managed to meet its deadline even though a major carrier, EL, was thrown into its lap only three months before the deadline, see *CUE Opinion*, 439 F.Supp. at 1386-87. Furthermore, we did not envision the possibility of regulatory reform at the time of the *CUE Opinion.* NEPA, which we viewed as a major stumbling block for the ICC,

439 F.Supp. at 1374, probably would have been rendered inapplicable to the ICC as it was to USRA. The ICC's "time consuming hearing requirements", *id.*, are less onerous than we then imagined, given that it had power to limit the submission of evidence to writing. Even the scrutiny it would have had to give to "considerations of competitive effect", *id.* at 1373, would have been lessened by analogy to the failing company defense of antitrust law, see *CMV Opinion*, 445 F.Supp. at 1009-10.

Still, assuming, as we do, that Congress would not have made major changes in the ICC's legal mandate, Congress would have had to allow at least somewhat more time for the ICC in the alternative scenario than it thought necessary to give the USRA in the real world. The ICC would have had to develop an adequate record to support its decisions on judicial review. *Swift & Co.* v. *United States*, 343 U.S. 373, 381-82 (1952); *I.C.C.* v. *Union Pacific R.R.*, 222 U.S. 541, 547-48 (1912). By comparison, the Final System Plan was not subject to judicial review, but only to review by Congress, see Rail Act §§ 208(a), 209(a)—and Congress was doubtless more interested in the USRA's results than in its reasons. Although its hearings could have been conducted mostly or entirely on paper, the ICC would have been bound to consider each argument raised by the scores of interested parties who certainly would have intervened. Solvent railroads that had bid unsuccessfully on a given line would have tried to convince the ICC that they could provide more or better service, or were in better financial condition, than the high bidder; other solvent railroads would have sought traffic protection conditions, which would have forced the ICC to study possible traffic diversions that might result from the sales; public bodies that were cast in the role of buyers of last resort for hopelessly losing passenger operations would have pressed the ICC to fob them off on the acquirers of potentially profitable freight lines; shippers could have been counted on to contest abandonments; and the ICC would have had to approve the labor protection agreements previously negotiated. We therefore find

that the fifteen months Congress initially allowed USRA constitutes a lower bound on the amount of time it would have allowed the ICC. For the reasons stated in the preceding paragraph, we find it is not a very distant bound.

Further insight can be gained by examining the large number of statutes enacted since the Rail Act that have placed time limits on the ICC's handling of sale and abandonment applications. Most closely analogous are three statutes specifically applicable to railroads in reorganization: the Milwaukee Railroad Restructuring Act, P.L. 96-101, 93 Stat. 736 (1979), the Rock Island Railroad Transition and Employee Assistance Act, P.L. 96-254, 94 Stat. 399 (1980), and the provisions of the new Bankruptcy Code applicable to railroads in reorganization, 11 U.S.C. §§ 1170, 1172. Section 5 of the Milwaukee Act, 45 U.S.C. § 904, transfers all jurisdiction over abandonments by the Milwaukee Railroad from the ICC to the railroad's bankruptcy court, and authorizes the court to set a time limit of six months, or even less if it chooses, on the ICC's deliberations over sale applications by the Milwaukee; in the latter case, the ICC may act without a hearing if it chooses, *id.* § 5(b)(2), 45 U.S.C. § 904(b)(2). Sections 1170 and 1172 of the Bankruptcy Code closely parallel the Milwaukee Act. Section 1111 of the Rock Island Act, 45 U.S.C. § 1009, fixes a maximum deadline of 100 days for ICC evaluation of sale applications filed by the Rock Island. These very short deadlines show great concern for the rights of creditors of an eroding estate, a concern that could only have been heightened in the non-Rail Act world, for each month's delay by the ICC would have cost the government a substantial amount of interim subsidies. Two enactments place time limits on ICC handling of sale and abandonment applications filed by any railroad, including ones not in reorganization. Section 402 of the RRRR Act placed a basic thirty-one month time limit on ICC consideration of sale and merger applications, although the ICC was empowered to violate that limit, if necessary, upon report to Congress. The Staggers Act of 1980 made that thirty-

one month time limit absolute, and shortened it to ten months for transactions other than mergers and acquisitions of control, which would be the case here.

The thirty-one month deadline set by the RRRR Act and confirmed by the Staggers Act is a plausible upper bound on the amount of time Congress would have allowed the ICC in the alternative scenario. It is contained in statutes of general applicability, and so it was designed to apply even to very large transactions. But for the reasons stated above, we think Congress would have imposed an even tighter time limit than usual in this case.[198] Between the lower bound of fifteen months and this upper bound of thirty-one months, we think that a range of twenty to twenty-four months is a reasonable estimate of the time limit Congress would have set.

Knowledge that Congress' provision of interim aid would be sharply limited in time would also have shrunk the period devoted to studies and negotiations. Shannon testified on behalf of EL that a study sufficient to support a "reasonable business decision" to buy portions of PC or EL could be made in six months. Shannon (D) (May 23, 1979) at 343, EL App. K at 163. That estimate is supported by two objective sources. First, an employee of Norfolk & Western, studying the possibility of a purchase of PC and other Ts by Norfolk & Western, Chessie, other solvent railroads, and public bodies, estimated in June 1973 in an internal memorandum that potential acquirers would be ready to bid within six months. Zeis (D) (May 8, 1980) Ex. 5, EL App. K at 245-246. Second, Chessie began serious negotiations with USRA over purchase of EL, R, and PC lines designated for sale to it by the Preliminary System Plan after only five months of study.[199] That transaction was similar in size and complexity to those in the alternative scenario, since it encompassed essentially all the freight lines in R's rail use proffer, including those originally proposed for the JT, most EL freight lines east of Akron, plus a branch of PC. See 3 GP at I 29. We have elsewhere noted that Chessie's study was a reliable one, see

pp. 85-87, *supra*, and the GPs give no substantial reason why its real-world experience would not have been comparable to what would have obtained in the alternative scenario. Nor do they even attempt to discredit Norfolk & Western's estimate. That neutral and contemporaneous judgment and Chessie's real world experience are far more persuasive to us than the GPs' evidence, which consists entirely of expert testimony prepared for this litigation. We therefore find that five to six months would have been sufficient time for potential acquirers to study the Ts, including PC, before serious negotiations could begin.

Further time would have been necessary for negotiations between the Ts, acquirers, and labor, and for any legislation necessary to enable public bodies to buy the Ts' properties. The evidence on how long would have been necessary to do that is surprisingly scant. The Ts offer virtually none.[200] The GPs consider that the limiting factors would have been labor negotiations and negotiations with public bodies. Several experts testified that labor negotiations would have taken two further years. See, *e.g.*, Myles (S) (Nov. 1, 1979) at 15-22; Luna (S) (Nov. 1, 1979) at 17-18. The one expert who gave a number for public body purchasers stated that they would have needed at least three-and-one-half years for study and negotiations. Whitehurst (S) (Nov. 1, 1979) at 45. We give little credence to this testimony, however, for all of these witnesses followed the GPs' erroneous assumption that unlimited financial assistance would have been available to the Ts. See Myles (S) (Nov. 1, 1979) at 2; Luna (S) (Nov. 1, 1979) at 2; Whitehurst (S) (Nov. 1, 1979) at 9. Furthermore, the GPs' two most important labor witnesses on this issue refused to accept the premise, required by the *CMV Opinion*, that Congress would not have stepped in to save jobs if the Ts had shut down. See, *e.g.*, Luna (D) (June 4, 1980) at 91, 8 RF App. Ex. 79.

As we have discussed elsewhere, labor would have been more pliant in such a situation than its history would suggest. An analogy is suggested by the Miami Accords, discussed at p. 115,

supra, negotiated in only a few weeks, which resolved the labor protection issues arising out of the reorganization of the Rock Island and Milwaukee Railroads. The Miami Accords thus show that labor negotiations can move quickly if the alternative is a complete shutdown.

All things considered, we estimate that the necessary studies could have been made and the Ts could have concluded sale agreements, including agreements on price, within ten to twelve months after PC announced its intention to liquidate. We further estimate that Congress would have set a twenty to twenty-four month deadline on the ICC's consideration of the Ts' sale and abandonment applications.

These conclusions imply that Congress would have had to provide interim assistance to the Ts in some form. We find that aid probably would have been provided in the form of grants, rather than priority loans. That the interim assistance provided for by the Rail Act was in the form of grants is persuasive of this.[201] That choice was not accidental; the legislative history shows that Congress believed that forced priority loans would have been unconstitutional. See Clausen (S) (Nov. 1, 1979) at 37-38. Whether a court should have held such forced loans unconstitutional is a difficult question that we need not decide. It is enough that Congress thought it was; Congress is entitled to give the creditors the benefit of its own understanding of the just compensation clause.

2. *Probable Actions of the ICC*

Our finding that Congress would have been likely to impose time limits on the ICC in the alternative scenario generally spares us the task of reconstructing the likely actions of the ICC in any detail. Nevertheless, two broad clusters of issues require discussion. First, the GPs argue that the ICC would have modified or placed conditions on the sale agreements and abandonment proposals presented to it by the Ts. Each of the modifications and

conditions they propose would have reduced the price the Ts would have realized. Second, the Ts challenge the GPs' assumption, which we have accepted *arguendo* thus far, that the ICC would have consolidated all the Ts' sale and abandonment applications and considered them together in a regional planning process.

(a) *Conditions Reducing Value*

The GPs argue that the ICC would have placed several kinds of conditions on the Ts' applications to sell and abandon their properties. At various points, they argue that the ICC would have required labor protection benefits for displaced employees, imposed traffic protection conditions to prevent undue diversion of traffic from solvent carriers' line, and approved sales of certain lines only if the acquirer agreed also to acquire either other lines slated for abandonment by the Ts or unprofitable lines slated for acquisition by public bodies. They so argue partly to support their timing argument by illustrating the complexity of the ICC's task, and partly because some conditions would in themselves have diminished the amounts the Ts would realize. Insofar as the GPs offer these arguments on the issue of timing, they are subsumed within our conclusion in the preceding section that Congress would have placed a time limit on the ICC's deliberations. Labor protection is discussed in Part IX.[202] Hence, only the contentions that the ICC could have conditioned the sale of some lines on acquisition of less profitable lines or of lines that would otherwise be abandoned need be addressed here.

These contentions lose much of their force because of our finding that the private acquirers of EL's and LV's main freight lines would have acquired those carriers' predominantly freight lines in the joint terminal area as well. See pp. 200-05, *infra*. Except for the contention that the ICC would have required the acquisition of lines slated for abandonment, the only lines to

which the GP's argument now applies are EL's passenger operations and, assuming that a solvent railroad would have been the high bidder for the AA's Toledo-Ann Arbor segment, the AA line north of Ann Arbor. The GPs offer considerable evidence that shippers onlines slated for abandonment and the public bodies slated to acquire these lines would have petitioned the ICC to foist them onto the solvent acquirers of those carriers' other lines. We are persuaded that they would have tried, but we hold that they would have failed.

In the *CMV Opinion* we "record[ed] our disagreement with the suggestion of the Government parties that the Interstate Commerce Commission would or could have used its power to withhold approval so as to insist on the inclusion of unprofitable mileage to a degree that would have driven down the price that purchasers would pay down to the level of scrap value . . ." 445 F.Supp. at 1010 & n.19. Although we also stated that "[w]e do not intimate that the Commission would have had no alternatives other than complete acceptance or rejection of the proposals as made", we had in mind such common conditions as traffic protection, trackage rights, or inclusion of other carriers. With one exception, the cases the GPs cite either involve conventional conditions or simply allude to the ICC's power to impose conditions in general terms; we distinguished those and similar cases in the *CMV Opinion, id.* The sole exception, and the GPs' only specific authority for conditions involving acquisition of unwanted trackage, *Chicago, Kalamazoo & Saginaw Ry. Acquisition,* 166 I.C.C. 265 (1930), is of little precedential value here. The condition imposed in that case required the addition of only two extra miles of track to a purchase of 10.3 miles. Moreover, that case was decided by a division of the ICC and was not reviewed by the full Commission or the courts, and we have neither been referred to nor found in our own research any instance where it has been cited or followed by the ICC in the fifty years since it was decided.

Assuming the ICC had power to condition the Ts' sales to solvent railroads on acquisition of substantial trackage slated for

abandonment or for acquisition by public bodies because of inability to operate at a profit—a question we need not decide—we reject the GPs' arguments that it would have done so. In the first place, if the GPs wished to show that the ICC would not have permitted certain branch lines slated for abandonment to go out of rail use, they bore the burden of coming forward with reasonably specific evidence that the ICC would have insisted on adding particular lines or sets of lines to the Ts' proffers, see Second Pre-Trail Order ¶ 9(e), Sp. Ct. Rep. at N 11800. The GPs, however, have made no attempt to show that any particular nonproffered line would have been added. Nor did they attempt to show that any particular nonproffered line did not qualify for abandonment under the ICC's usual standards, even though their own witness stated that the ICC would have relied substantially on established abandonment criteria. Corber (S) (Jan. 31, 1979) at 42. Hence, as to lines slated for abandonment, the GPs' argument fails for want of proof.

Furthermore, we seriously doubt that the ICC would have conditioned acquisition of EL's main freight lines on the acquirer's conducting EL's passenger operations, regardless of pleas by New Jersey for it to do so. The relative bargaining strengths of solvent acquirers and the State would have been the same as they were in the negotiation phase. For the reasons discussed at pp. 207-09, *infra*, solvent acquirers almost certainly would have refused to undertake those carriers' passenger services on any terms, even to the point of preferring to let the Ts' freight lines go out of rail use. The solvent acquirers could credibly threaten to walk away from the entire transaction if the ICC imposed such a condition and the GPs recognize that the ICC could do nothing to stop them. 6 GP at W 41-42; see also ELRB at 270-71. The GPs suggest that the ICC in that circumstance could have required EL to operate a viable pared-down core system; but, passing the question whether the ICC could constitutionally have done so, the record contains no evidence that EL had any such viable core standing alone. Unable to sell

any part of its system with such a condition imposed and unable to operate it profitably, EL would have had a constitutional right to cease all its operations. See *CUE Opinion*, 439 F.Supp. at 1356-57, 1364. The GPs' own witnesses, however, testified that the ICC's "foremost objective" would have been to preserve needed rail service. Corber (S) (Jan. 31, 1979) at 19. Because there would have been no real doubt that EL's passenger operations would have been kept in service by public bodies in any event, and because a stubborn attempt to foist them onto solvent railroads could well have resulted in loss of the entire EL system for rail use, the ICC almost certainly would have refused to gamble.[203]

This reasoning does not apply to AA, since Michigan stood ready to buy the Toledo-Ann Arbor segment if a solvent bidder for that branch balked at a condition that it also acquire the lines north of Ann Arbor. But the only reason the GPs advance for supporting that the ICC would have conditioned the acquisition of one line on another is that the ICC "would have prevented the transferor from skimming the cream from their systems, while in allocating to public bodies the cost of operating other transferor lines essential to both the public interest and the very earnings claimed by the transferors". 6 GP at X 11. Passing the "public interest" clause, which the GPs do not expand upon, that reason does not apply to AA, for the earnings value of its Toledo-Ann Arbor segment does not depend on traffic from the northern line. See p. 280, *infra*. Such a condition would tend to drive the price AA could realize down to X. But the GPs' own evidence is that the ICC would not deliberately have sought to reduce prices paid to the Ts without a good reason. Corber (S) (Jan. 1980) at 24. Because the GPs do not suggest a reason, we find that the ICC would not have imposed such a condition.

Appendix H

(b) *Early ICC Approval of Particular Transferors' Sale and Abandonment Applications*

In our *CUE Opinion* we indicated our preliminary view that "[t]he solution which the ICC would have had to devise to the regional rail crisis would have involved a complex piece of regional planning, and we think it unlikely that the ICC would have tied its hands early in the proceeding by permitting abandonment or sale of major lines even before it knew what shape the surviving system might take." 439 F.Supp. at 1375. As we envisioned this regional planning process, the ICC would have recognized in advance the possibility or likelihood of interrelationships between the various Ts' sale and abandonment applications. It therefore would not have given individual applications detailed attention until all sale applications, or at least all of the major sale applications, were before it. All of the applications would have been consolidated and studied as a whole, and the ICC would not have permitted any single transaction to be consummated until it was ready to give its approval to all of them. Consolidation of the Ts' applications thus has an important effect on the time at which each could have completed its sales and abandonments.

No T except CNJ has gone so far as to argue that it would have reached agreement with a purchaser and received all necessary administrative approvals before it became clear that other Ts were also going to propose major sales and abandonments, and we reject that argument at pp. 305-09, *infra*. Nevertheless, several Ts take issue with our preliminary view in another way: they argue that they could have persuaded the ICC to approve part or all of their transactions before those of the other transferors—principally PC—even after the need for regional planning became evident.

The evidence is clear that the ICC would have entertained a strong presumption in favor of consolidation of all the Ts' applications. In its report rejecting the PC trustees' proposal to liquidate, the ICC emphasized the need for a "solution which deals

with Penn Central in the context of a territory-wide approach encompassing the other carriers serving the Northeast". *Penn Central Transportation Co. Reorganization,* 347 I.C.C. 45, 112 (1973). GP witnesses Robert Brooks, who was director of the ICC's Office of Proceedings at the time the Ts' applications would have been filed in the alternative scenario, and Robert Corber, who served as a Commissioner of the ICC from 1975 to 1976, both testified persuasively that they would have followed that course.[204]

None of this evidence focuses on the situations of particular Ts, but it places a very heavy burden on the Ts to demonstrate that it would have been an abuse of discretion for the ICC not to consider and approve a particular transaction before the others. That burden can be met only if, at a minimum, it is shown that, first, advance approval of the transaction would not have tied the ICC's hands with respect to other transactions in any important way, and second, the transaction would have been essentially unopposed. The first requirement, noted in the passage from the *CUE Opinion* quoted above, needs no explanation. The second is a consequence of the relatively short time limit we have assumed that Congress would have set on the ICC's deliberations. Before 1973, contested sale and abandonment transactions of any size rarely if ever received administrative approval in less than the twenty to twenty-four months we assume that the ICC would have had; the creditors of the Ts' estates could not reasonably have expected them to conclude sooner. Given its past record, any procedures used by the ICC that resolved large, contested sales and abandonments within this short a time would have been per se reasonable in our view. Only large transactions are in issue, however, for in accordance with the warning in our *CUE Opinion,* 439 F.Supp. at 1375 n.40, the Ts direct their early-approval arguments only to their entire systems or major portions thereof.

We conclude that none of the T's has met this burden. EL does not attempt to show that it could have escaped consolidation of its

case with PC's. None of the other T's has made the necessary showing that its disposition would have gone unopposed before the ICC. Abandonments would doubtless have been opposed by shippers on the relevant lines. See Hansen (S) (Nov. 1, 1979) at 7-8. Public bodies faced with having to acquire losing lines would likely have tried to persuade the ICC to include those lines in another system. See Stangl (S) (Nov. 1, 1979) at 17. And sales to solvents would have raised opposition from other solvents who had submitted competing bids, from solvents seeking traffic protection conditions, and from shippers seeking to condition the acquisition of profitable lines on acquiring lines slated for abandonment.[205]

Apart from the general question of opposition to their respective dispositions, each of the Ts remaining in the case (except EL) presents its own specific arguments for early disposition. We discuss and reject the arguments of CNJ in Part XIII, *infra*. Here we find that the arguments of LV and AA are also without merit.

LV argues that by June 1973 it was well on its way to cessation of its rail operations, and that the ICC would not have been likely to "stop LV in its tracks so that the other Transferors could catch up". LVRB at 17. LV also argues that because of its small size, its disposition would have posed few problems for the ICC. *Id.* Both arguments are apparently intended to apply only to LV's stand-alone case. See LV at 8. Although we have not discussed this case in detail, we think it founders for lack of identification of even one, let alone two, competitive bidders. If these contentions are meant to apply to an EL-LV acquisition, then they clearly lack merit. Neither LV's progress in its reorganization nor its size would have been relevant if its disposition were bound to EL's.[206]

AA argues that its small size and relative geographic isolation would have rendered it unnecessary for the ICC to include it in any regional planning process. AA at 36-39. As the GPs correctly point out, however, 2 GPRB at U 22-23, the argument that

AA's disposition would have preceded PC's is inconsistent with AA's own premise that the earnings value of the Toledo-Ann Arbor segment would have been established by the bidding of an acquirer of PC's IFLs. Moreover, AA has not demonstrated that its sale would have been unopposed. As AA strenuously argues, there would have been numerous bidders for its profitable Toledo-Ann Arbor segment. AA at 28. Any sale would thus likely have been opposed before the ICC by the unsuccessful bidders. The State of Michigan, faced with the prospect of acquiring AA's losing northern segment, would doubtless have tried to persuade the ICC to require the private purchaser of the Toledo-Ann Arbor segment to take the northern segment as well. As in the cases of the other Ts, the ICC would have taken the full reasonable time available to it to consider these objections.

(c) *Necessary Transactions Following Approval*

Conveyance of the Ts' properties in the alternative scenario would have been neither automatic nor immediate after ICC approval. Undoubtedly a few "tag ends" would remain to be tied up. Shannon (D) (May 24, 1979) at 575, El App. K at 187.[207] The GPs contend that the transactions could not have been completed until at least eight months after they were approved by the ICC. 6 GP at T 147. EL's witness, Shannon, on the other hand, testified that two months would have been sufficient.[208] Our review of the evidence and arguments indicates that Shannon's estimate is more nearly accurate.

The GPs' estimate of eight months rests on four assumptions, all of which we find flawed. First, the GPs contend that renegotiation resulting from conditions that the ICC would have imposed on the sales would have taken time. 6 GP at T 148. But we have already held that the ICC would have imposed no conditions of any significance. The GPs also argue that conveyance would have been delayed by petitions for reconsideration that opponents

of the transactions would have filed with the ICC. The Commission, however, would have placed a strict time limit on the filing of petitions for reconsideration and could have been expected, in line with the congressional policy, to decide them very promptly. The GPs' third argument, and perhaps its best, is that opponents of the approved transactions would have sought and obtained judicial review of the ICC's actions, and that this would have resulted in significant delays. 6 GP at T 50. There is evidence, however, that approval by reorganization courts would have been almost immediate.[209] It is likely that any reviewing court, faced with both a clear congressional policy reflected in the deadline imposed on the ICC and the possibility of massive shutdowns, would have moved most expeditiously. Indeed, as in the case of the Rail Act's provision that this court must decide appeals from the initial decisions of the reorganization courts within 80 days, § 207(b)(1), Congress could well have placed severe time limits on the taking and decision of appeals. The GPs' final argument, that arrangement of credit terms would have delayed the process, 6 GP at T 151, is also without merit. The needed financing could and would have been assured before the sales agreements were concluded.

C. *Conclusion*

Arriving at a precise date on which the Ts' properties would finally have been conveyed in the alternative scenario is now a matter of summarizing the conclusions we have reached and performing arithmetic. The process of disposing of rail properties would have begun in February 1973. Studies by acquirers of the properties and negotiations would have taken ten to twelve months, and ICC deliberations would have taken twenty to twenty-four months. Taking into account the possibility of judicial review, the properties would have been conveyed about April 1, 1976.

We recognize that in arriving at this date we have relied on crude estimates for each phase of the process. Our result necessarily reflects the roughness of its components; some of the periods may be too short, others too long. The conveyance of Ts' properties *might* have taken place somewhat earlier or somewhat later than April 1, 1976. But we are satisfied from the evidence that this is the most likely date, and that neither an earlier nor a later disposition is any more likely. In our *CUE Opinion* we held, tentatively, that conveyance would not have occurred before April 1, 1976. Today we reaffirm that holding, and hold further that it would have taken place no later.

XI. Acquisitions by Public Bodies

The JTTs allege that public bodies in New Jersey and Pennsylvania would have paid net salvage value to acquire their predominantly freight lines in the terminals areas and would have paid prices greater than net salvage value to purchase their predominantly passenger lines.[210] The GPs' assault on these contentions is multifaceted. The GPs categorically reject the notion that the JTTs could have erected a firewall between their allegedly profitable main freight lines in the west and the losing public body lines in the east. In the GPs' view, public bodies would not have paid some $265.5 million for the predominantly freight lines within the JTs,[211] and another $265.1 million for the predominantly passenger lines,[212] when the continued operation of these lines was essential to the JTTs' realization of earnings values from the sale of the main freight lines. Moreover, the GPs allege that the acquisitions envisioned by the JTTs would have imposed an additional operating burden on the public bodies of $250 million annually.[213] In light of the difficulties faced by states in the Northeast in the mid-1970's, the assumption of such staggering costs would have been unlikely. Rather, public bodies would have used every means at their disposal to keep ownership of the "public body" lines in private hands. This would have involved attempts, including offers of financial subsidies if necessary, to induce the potential purchasers of the JTTs' main freight lines to

In addition to these factual contentions, the GPs present a number of legal arguments against awarding values to the Ts based on hypothetical sales to public bodies.[214] First, the GPs maintain that the Ts' claims impermissibly assume changes in state law that were not reasonably foreseeable in February 1973. Second, they allege that the Ts mistakenly based certain of their claims on actions by the federal government that would have amounted to alternative, long-term federal responses to the rail crisis. Third, the GPs argue that federal condemnation law forbids compensating the Ts for the value to the public or social value of their properties. Fourth, the GPs contend that the Ts' cases offend the Supremacy Clause by relying in several respects on limitations on state power that do not bind the federal government.

As a threshold question, the GPs hotly contested the JTTs' classification of terminal area lines into "predominantly freight" and "predominantly passenger" segments. In classifying their lines, the JTTs followed a rule of thumb dubbed somewhat derisively the "six-train rule" by the GPs. As described by the JTTs' witness:

> A line was deemed to be predominantly passenger if it was used for (i) six or more round trips per day of passenger trains regardless of freight density; or (ii) some passenger trains but less than six round trips per day of freight operation. All other lines were considered to be predominantly freight lines.

Storm (S) (JT) (Dec. 15, 1978) at 7 n.1.

In their briefs the GPs attack the six-train rule as designed to result in the smallest possible amount of trackage being designated predominantly freight. The JTTs' classification yielded a system in which, with few exceptions, every segment that carried any passenger traffic was designated a passenger line even though virtually all of these also carried some freight traffic, and some carried substantial amounts of freight traffic. Lines designated

as predominantly freight were almost without exception those dedicated exclusively to freight service. See Tomlinson (S) (JT) (Dec. 1, 1978) at 12-13. Moreover, the GPs argue, the predominantly freight lines do not form a contiguous system.

According to the GPs, the minimization of the predominantly freight trackage benefits the JTTs' case in three ways. First, because the JTTs allege that predominantly freight lines would have been acquired at net salvage value, while passenger lines would have brought a premium in excess of net salvage value, maximizing the passenger trackage would yield greater sales proceeds to the JTTs. Second, regardless of any passenger premiums, if the predominantly freight lines were included in the sales of the main freight lines to solvent railroads at no extra cost, while the predominantly passenger lines were sold to public bodies for net salvage value, maximizing the number of passenger lines would similarly increase the total proceeds from these sales. Third, reducing the number of predominantly freight lines minimizes the switching costs that the JTs would have charged back to the connecting line-haul carriers, thus inflating the earnings values of the main freight lines.

We resolve the dispute over designation of lines by accepting most of the contentions of both sides. We agree with the JTTs that the existence of important commuter service distinguishes the predominantly passenger lines because only the public would have provided the necessary funding to keep the passenger operations running. See pp. 207-11, *infra*. The GPs' objections center upon the enhancement of value of the JTTs' lines as a whole that results from the JTTs' designations. As the GPs' counsel put it at oral argument, "it doesn't matter whether you call something a passenger line or a freight line, or you call it a rail line, or you call it a tangerine. The important point is the way that you allocate costs." Tr. at 303. We accept the GPs' objections in determining the prices that public bodies would have paid for the predominantly passenger lines, see pp. 231-44, *infra*, and the trackage rights fees public bodies would have charged for

use of the passenger lines for freight movements, see pp. 244-51, *infra*. The GPs' arguments we accept as to the passenger lines are largely the same as those we accept as to the predominantly freight lines in the terminal areas. The analysis of these freight lines is more straightforward in that there is no need to consider complications introduced by the presence of passenger traffic on the same lines. Thus we begin our examination of the prospects for public acquisition by considering the JTTs' case for creation of public joint freight terminals.

A. *The Joint Freight Terminals Case*

Despite the great expense and the extensive studies the JTTs undertook in formulating the JTs case, their argument that public bodies would have acquired the terminal freight lines and set up JT companies is surprisingly weak. The JTTs do not claim that it would have been necessary for public bodies to have purchased the predominantly freight lines as a last resort, stepping in reluctantly to avert the disaster that cessation of freight service in the terminals areas would bring. On the contrary, the JTTs maintain that private purchasers of the main freight lines would have been willing to acquire the predominantly freight lines in the terminal areas as well had the public bodies declined to venture into the freight business. See 1 ELF at 57-59 (EL-LV); 1 RF at 192-213. The JTTs' position is that, having solved their most vexing problem by acquiring the predominantly passenger lines, public bodies would have forged ahead and purchased the predominantly freight lines in order to create the JTs. The primary purpose of the public bodies in undertaking these projects would have been to promote industrial development by eliminating duplicative facilities and providing more efficient service to connecting carriers and local users. Combined ownership of the freight and passenger lines in the terminal areas would also have allowed better coordination of the two types of traffic, including reduced interference between freight and passenger trains and

insured equality of access to freight service by industries in the area. Public purchase of all the Ts' terminal properties would have been more likely than piecemeal acquisitions by individual solvent railroads, since the acquiring roads would not have been able to achieve the economies made possible by a unified public acquisition and also would have been unwilling to risk being saddled with responsibility for passenger operations. See Hesse (S)(JT) (Dec. 15, 1979) at 29-30.

There is a fundamental problem with the JTTs' argument. While the central purpose of the JTs was to eliminate duplicative facilities and services and to cut switching costs, the JTTs presented no evidence to show that the JTs' switching charges were lower then the switching costs that would have been encountered by prospective purchasers of their main freight lines in the absence of the JTs. In fact, evidently concerned that the GPs' assault on the JTs case might prove successful, the individual JTTs alleged alternative outcomes in which switching costs on their lines would have been lower and earnings values correspondingly higher without the "benefit" of the alleged economies achieved by establishment of the JT. See Statement of EL Trustees in Response to the Court's May 21, 1981 Memorandum (June 1, 1981) at 8-9, Sp. Ct. Rep. at N 35818-19; ELRB at 124-28; 1 RF at 192-213. EL suggested at oral argument that the NJ/NYTerms' switching charge might have been advantageous to purchasers of the lines of some of the Ts, such as PC, but not to purchasers of others, such as EL or EL-LV. See Tr. at 54-55. And the fact that the JTTs themselves never even attempted to form a JT in the real world suggests that the prospects for effecting major savings while preserving the status quo of traffic distribution had never been thought very good.

Beyond this, we do not think that a solvent railroad interested in buying a T's main freight line would have been reluctant to purchase the T's predominantly freight lines as well. These were not segments that the solvents could afford to ignore.[215] Without the continued operation of the terminal lines, the sales of the main

freight lines would not have been possible. See Hesse (D) (May 2, 1979) at 132, 11 GP Supp. App. at 180. The inability of individual purchasers to achieve the economies alleged to be possible in a JT would at best have affected only the price a solvent railroad would have been willing to pay for the package and not its willingness to buy. Indeed, prospective purchasers of EL and LV would have had reason to regard the creation of the JTs with some apprehension. Unlike publicly owned terminal railroads in other cities, which are rather local in extent, the terminals proposed by the JTTs cover vast areas.[216] In New Jersey, for example, the terminal includes LV's main line, spanning 76 miles from Jersey City in the east to Phillipsburg in the west, R's line running 27 miles from West Trenton north to Bound Brook, and 42 miles of the old Lackawanna line from Dover to Phillipsburg, much of which lies in areas of the State far from the New York port and which no one, prior to this litigation, ever would have conceived of as forming part of a terminal railroad. We are also incredulous that a Western purchaser bent on creating a transcontinental system would have been content to stop at the western border of New Jersey, leaving control of its entry to New York in the hands of a public agency that lacked any experience in freight service.

A purchaser's apprehension at this state of affairs would only have been increased by the ambitious design of the JTs experiment. Even if we were to assume that the public bodies would have followed the JTTs' detailed operating plans and costing decisions to the last letter, purchasers of the main freight lines would have had to consider the significant risk that savings achieved on paper would not have been realized in the yards. A prospective purchaser of the main freight lines would thus have to reckon with a host of unknowns, including the possibility that a public terminal's switching charge might have exceeded the costs the purchaser would incur by acquiring and operating the predominantly freight lines itself, or that existing traffic patterns in the terminal area would be disturbed to its detriment.

Moreover, it is somewhat incongruous for the JTTs to argue that Western railroads would have engaged in competitive bidding to acquire their main freight lines to the east in order to protect or promote their position but would have declined to compete in the terminals area where much of the traffic they desired originated. Even if a purchaser were agreeable to the creation of a JT, it would have had cause to fear that an aggressive competitor acquiring another main line would have insisted on purchasing some of the predominantly freight lines for itself in order to gain a competitive edge. For all these reasons, solvent railroads looking to acquire the main freight lines probably would have taken a cautious attitude towards the establishment of publicly owned JTs.

None of this is to suggest that if the public bodies had insisted on acquiring the JTs properties, purchasers of the main freight lines would have absolutely refused to cooperate. We doubt, however, that public bodies would have been particularly interested. The chief reason cited by the JTTs why public bodies would have sought to acquire the JT lines is their desire to take advantage of the unique opportunity provided by the rail crisis to rationalize and upgrade terminal facilities and services, thereby improving the climate for industrial development. As evidence of this, the JTTs cite several studies and reports recognizing the need for consolidation and modernization of rail facilities in the New York and Philadelphia port areas, see JT at 29-30 & n.19, a need which the GPs do not dispute. The JTTs, however, have not provided any credible evidence that New Jersey and Pennsylvania would have volunteered to undertake these grand projects in the circumstances of the alternative scenario. By contrast, the GPs rely on a bevy of public transportation officials who uniformly testified that public bodies had virtually no history of involvement in freight service,[217] that freight service had long been regarded as the responsibility of the private sector, and that acquisition would have been considered only if the alternative was abandonment of essential freight lines. See Altshuler (S) (Nov. 1, 1979) at 23;

Simon (D) (Apr. 20, 1979) at 47, 20 GP Supp. App. at 50; Stangl (S) (Nov. 1, 1979) at 20-21; Stangl (D) (Mar. 19, 1980) at 198-99, 256, 19 GP Supp. App. at 728-30; Tennyson (D) (Mar. 19, 1980) at 38-39, 43-45, 20 GP Supp. App. at 714-18; Whitehurst (S) (Jan. 30, 1980) at 46-49. In the words of one New Jersey official, in 1974

> the state was concerned about the possibility of being required to take a more direct role in the passenger business and the last thing we wanted to do or, in fact, were prepared to do, was get into the rail freight business.

Stangl (S) (Nov. 1, 1979) at 20.

Moreover, as developed below in our discussion of the financial feasibility of public acquisitions, public bodies' efforts to come up with the funds necessary to acquire and operate the passenger lines would hardly have been painless. While we do not say that they would have been unable in addition to finance a purchase of the predominantly freight lines if this were necessary to preserve freight traffic, it is rather plain that public bodies would not have been willing to spend the amounts sought by the JTTs solely to attain new heights of freight service. The only immediate beneficiaries of such largesse would have been the bankrupts, which would have raised their asking prices for the main freight lines to the extent that the costs of terminal services were reduced and also would have realized additional amounts from the separate sales of the terminal lines to public bodies. The public benefits of more efficient terminal services, if realized at all, would doubtless have taken years to emerge.

This leaves only the argument that combined public ownership of the freight and passenger lines would have had the advantage of increased possibilities of coordination of rail service. Contrary to the JTTs' view, public bodies would have had no need to acquire the terminal lines to reduce interference between freight and passenger trains, since virtually all of this would have

occurred on the passenger lines they are already presumed to control. Insuring equal access to freight service is hardly a sufficient incentive to justify an investment of hundreds of millions of dollars. We conclude that public bodies would have resisted buying the predominantly freight lines and that these would have been acquired instead by the purchasers of the main freight lines.[218] We thus do not reach the complex issue of the reasonableness of the switching charge computed by the JTTs.

B. *Predominantly Passenger Lines in Northern New Jersey*

We find that EL's passenger lines in the North Jersey area would have been publicly acquired in the absence of the Rail Act.[219] In reaching that conclusion, we consider the strength of public bodies' motivation in the alternative scenario and their legal and financial capacity to consummate the acquisitions. After resolving the likely disposition, we face the more complex questions of what price would have been paid for EL's passenger lines and what trackage rights fees would have been charged for freight movements over the publicly acquired passenger lines.

1. *Legal Capacity*

As a threshold question the GPs contend that, since none of the states involved possessed the legal authority to acquire railroads and the requisite changes in the law were unforeseeable, acquisition by public bodies may not be considered in determining the value of the Ts' property.[220] The legal rule cited by the GPs is applied when a condemnee's valuation is premised upon a hypothesized private purchaser that would have put the property to a new use forbidden by law. But, for example,

> [w]here . . . there is a possibility or probability that the zoning restriction may in the near future be repealed or amended so as to permit the use in question, such likelihood may be considered if [and to the extent that] the prospect of such repeal or amendment is sufficiently likely as to have an appreciable influence upon present market value.

4 Nichols, Eminent Domain § 12.322[1] (3d ed. 1979) (footnote with citations omitted). In this case, however, the potential buyer is the very body that makes the law. The absence of preexisting authority cannot, therefore, be said to diminish the prospect of public acquisition since a state's decision to purchase portions of the Ts' railroads would be embodied in legislative or constitutional enactments providing the necessary authority.[221] Since we reject out of hand the applicability to this case of the legal principle cited by the GPs, we will forego examination of various Ts' responses to the factual predicate of this argument. Thus, the only two relevant questions are the ones we turn to next: whether New Jersey would have been sufficiently motivated to acquire the Ts' passenger operations in the absence of the Rail Act[222] and whether New Jersey would have had the financial capacity to complete the transaction.

2. *Public Acquisition*

The GPs' further response to the Ts' passenger cases is a variant of their general argument that, so long as substantial profits were projected on the main freight lines, public bodies would have refused to buy any lines on which those profits were dependent. Just as public bodies would have opposed the erection of an artificial firewall between the main freight lines and the predominantly freight lines in the JTs, so would they have resisted the establishment of an "inner" firewall between privately owned, profitable freight lines and publicly owned, losing passenger lines. Rather than acquiesce in such "cream-skimming", public bodies would have sought to persuade the private purchasers of the Ts' main freight lines to buy and operate the passenger properties as well. If necessary, public bodies would have offered to raise their passenger service subsides above the avoidable cost level. If that effort failed, states would have proceeded to petition the ICC to condition approval of a sale of the main freight lines on inclusion of Ts' passenger properties. See pp. 188-91, *supra*. If all these

efforts proved unsuccessful, public bodies would have been forced by lack of funds and the political infeasibility of increased spending for public transportation to acquiesce in the abandonment of the passenger lines. Given the alternatives of increased bus and automotive transportation, the consequences of a shutdown of rail passenger service would not have been so catastrophic as to foreclose it as an option. Finally, the GPs contend that even if public bodies did agree to buy some of the Ts' passenger lines, they would not have agreed to buy them all. We shall address each of these contentions in some detail. In this subsection we consider how strong New Jersey's interest in acquiring EL's passenger lines would have been in the absence of the Rail Act.

EL stands on rather firm ground with respect to public acquisition of its passenger lines. EL emphasizes that no solvent railroad contemplating a purchase of its main freight lines or of the EL-LV package would have been willing, or could have been forced, to go through with the deal if responsibility for the passenger service was included, see Shannon (S) (EL) (Dec. 31, 1978) at 91, because passenger service had been a losing proposition for many years and a substantial drain on the bankrupts providing it. Although public bodies were heavily involved in subsidizing passenger service, they had insisted on paying no more, and in some cases less, than the avoidable costs of passenger operations.[223] Under this approach, common costs such as track maintenance were allocated to the "base" or freight service. See Whitehurst (S) (Jan. 30, 1980) at 7. EL's witness Shannon bluntly stated:

> [R]unning passenger service is a pain. It's politically oriented. I've been in the passenger business for almost 25 years and ran suburban service and nobody in their right mind will buy it, except the public.

Shannon (D) (May 23, 1979) at 389-90, ELP App. at 79-80.

When pressed, Shannon did state that a private purchaser theoretically would have been willing to assume responsibility for

conducting passenger operations if guaranteed 100 percent subsidization of operating deficits plus a fair return on investment. He thought that under those conditions it would have been cheaper for the State to buy and operate the passenger service itself. Shannon (D) (May 23, 1979) at 381-86, ELP App. 87-93. That seems most unlikely since, even if operating costs would have been lower under public ownership, the public would have saved the full acquisition price if it could have succeeded in having the lines included in the sales of the main freight lines without affecting the price in the private sale. But there are other reasons to believe that the passenger lines would have been disposed of differently from the freight lines. Potential acquirers of the freight lines would have been reluctant to become involved in passenger service even indirectly, for there was no likelihood that any public body would make, or could persuasively claim to make, a guarantee of 100 percent subsidization for the indefinite future. Further, since the demands of scheduling passenger service are greater than those for freight, a public body would have seen some advantage in owning the passenger lines so as to minimize scheduling conflicts. Finally, if New Jersey had not been willing to purchase EL's passenger lines, at least some of them would have been abandoned since they would net more to EL as scrap than if they were included in a freight package.

This is not to deny that New Jersey would have been reluctant to purchase and operate the passenger lines or that the State would have attempted instead to persuade the solvent railroads to accommodate it. It is simply to say that the State's arguments in this regard would have lacked force. The weakness of the State's position is reflected in the evidence on this point. While the GPs produced several witnesses who testified that public bodies would have tried to negotiate a private purchase of the passenger lines, one was willing to say that such efforts would have been likely to achieve their goal. By contrast, EL's witnesses emphatically denied that any solvent railroad could have been persuaded to

enter the passenger business. This testimony went without significant contradiction, and is corroborated to some extent by the fact that in connection with the FSP proposal that Chessie buy EL and R, "it became clear that as a condition of purchasing these properties, Chessie did not want to assume the obligation of negotiations with the commuter authorities." 1 FSP at 46 n.5. As a result, USRA recommended that Chessie not acquire any passenger lines but rather obtain trackage rights over them for freight service. *Id.* at 232-33.

We think that New Jersey, unlike a private acquirer, would have been willing to purchase EL's passenger lines. These lines, including about 165 miles running through some of Northern New Jersey's most heavily populated bedroom communities, see EL Map 1, carried more than 35,000 passengers in each direction on an average weekday. The lines ran to Hoboken and Newark, and connected to the PATH rapid transit system to Manhattan at Hoboken. New Jersey had demonstrated its financial commitment to EL's passenger service over the years in the form of operating assistance payments, capital improvements, and various kinds of tax relief. The size of these operating assistance payments had been rising dramatically in the 1970's—$5.2 million in 1970, $9.1 million in 1973, and $17.9 million in 1975. See Ex. ELR-NJ-1 at 3, ELP App. at 16. While some of the publicly financed capital improvements had been paid for by federal as well as State funds, others were shouldered exclusively by the State, as evidenced by the purchase between 1967 and 1972 of 155 passenger cars and 32 locomotives at an approximate cost of $41 million.[224] See Ex. PCT-NJ-48 at A 17, ELP App. at 23. We find it hard to believe that New Jersey could have seriously contemplated abandonment of the State's passenger lines. See Ex. PCT-NJ-13 at 1-2 (Transportation Commissioner Kohl) ("40 lanes of expressways would be necessary to provide equivalent travel during rush hours," which would entail "huge cost [and] would be socially and environmentally unacceptable"); Ex. PCT-NJ-114 at 5-7 (Commissioner Kohl)

(infeasibility of transferring rail commuters to buses and automobiles); Ex. ELR-NJ-6 vii (New Jersey Commission on State Tax Policy) ("great public cost, if not impossibility, of providing equivalent highway transportation facilities").

Apart from the State's need to purchase its lines to keep the passenger trains running, New Jersey would have some affirmative motivation to make the acquisition in order to achieve the financial and operational control that comes with ownership. This advantage was becoming increasingly clear to State transportation officials during the 1970's as the cost of subsidizing private carriers rose while service declined, and was in fact cited by the State in 1978 when it acquired the major portion of EL's passenger lines. See ELP at 19-27. Unless the State took this next logical step to ownership, it would have had to face the prospect of continuing to sink huge sums into capital improvements and to pay out ever larger subsidies to an entity which had no incentive to improve service or achieve economies and over which the State had no legal control.

In all, EL's commuter service was too important to the State for abandonment to be considered a realistic option. New Jersey could not have convinced solvent railroads or EL to include losing passenger lines in the sale along with EL's freight lines. Under these circumstances, New Jersey would have had no choice but to acquire EL's passenger lines. The Ts' cases for public acquisition of their predominantly passenger lines are not immune, however, from our criticisms of the JT case since these lines did carry freight traffic. But arguments that were decisive against public acquisition in the case of the terminal freight lines have an impact in the case of the passenger lines limited to the prices public bodies would have paid and the trackage rights fees they would have charged.

Appendix H

3. *Financial Capacity*

The GPs allege a second barrier to New Jersey's purchase of EL's passenger lines for continued rail use: the inability of the State to finance the acquisition.[225] Most of their analysis, however, purports to be offered in support of the more limited proposition that "the financial constraints on public bodies would have reinforced their determination to pay no more than the minimum for any lines".[226] We find this latter proposition persuasive; in fact, it was conceded by EL's only witness on the issue of New Jersey's financial capacity. Cahill (S) (EL) (Oct. 15, 1980) at 10. But the GPs' broader contention fails. Their reply brief properly identifies the question. After conceding that virtually no single undertaking would be impossible financially, it states "the financial ability issue . . . cannot realistically be divorced from the practical ability and political willingness of public bodies to cut existing programs and impose new taxes", 2 GPRB at K 17. Yet the GPs' argument fails to meet this issue, since it analyzes the alleged historic unwillingness of New Jersey to commit massive funding to public transportation projects as though the rail crisis would have had no impact upon its financial decisions.

Examination of New Jersey's financial capacity must begin with reference to the cost of taking over the passenger lines. Based upon the Ts' allegations, the GPs indicate that the total acquisition cost for all of the proffered public body lines in New Jersey would have been approximately $518 million.[227] 4 GP at P 132 (Chart P-1: "New Jersey as Fairy Godmother"). From this must be subtracted the costs of the JT freight properties, leaving a total of some $363 million—a figure including $109 million for the Northeast Corridor Spine and $100 million claimed by CNJ for its freight and passenger lines. This figure is an upper limit since it assumes that the Ts will prevail on all their contentions relating to prices that public bodies would have paid. Since we reject EL's claim for a premium above X, see pp. 218-31, *infra*,

and accept the GPs' argument for deductions from X, see pp. 231-44, *infra*, it is evident that the $363 million figure substantially overstates the actual financial requirement. And to the extent that any of the GPs' claims in the nonrail use phase of the case prevail, the burden would have been even less.

An additional financial burden would have resulted from the State's assumption of all operating costs of the proffered lines.[228] The GPs' estimates place the annual burden, above preexisting commuter subsidies, which amounted to $30 million in 1974, at nearly $110 million. 4 GP at P 135. For purposes of determining the State's ability to finance the takeover of passenger lines, the figures are overstated in that nearly half of the alleged increase is to cover the cost of freight operations in the NJ/NYTerm. See Aaron (S) (Jan. 30, 1980) App. J at Table 2. Thus the $30 million subsidy already being expended in 1974 was a substantial fraction of the alleged total, and, because the subsidy had been increasing, see p. 210, *supra*, the amount by which the total burden would have exceeded subsidy levels absent public acquisition would have been even less in future years.[229]

The GPs also present evidence from First Boston indicating the hypothesized increases in New Jersey's sales, corporate income, and motor fuels taxes that would have been necessary to finance $114 million in annual operating burdens in an attempt to put their operating cost estimates in perspective. First Boston's figures, present a somewhat distorted figure because they are based on the assumption that only one revenue source would shoulder the full burden, First Boston (S) (Jan. 30, 1980) at 42, giving an impression that in effect triple-counts the total cost.[230] Their budget figures, *id.* at 44-45, repeat this illusion by implicitly assuming that the entire burden would be met by budget cuts concentrated in a single area.[231] If, more realistically, this burden were spread among tax increases and budget cuts in several areas, it seems clear that the burden would be bearable in light of the public necessity.

The GPs correctly note that the mid-1970's were a time of tight money, when numerous demands competed for limited State funds. 4 GP at P 69-87; 2 GPRB at K 31 & n.48. The GPs argue, for example, that New Jersey's historically low government expenditures reinforce the conclusion that the State would have been inclined to spend as little as possible. 4 GP at P 145 (indicating, for example, that New Jersey ranked 49th among the states in per capita government expenditures per dollar of disposable income). But this also cuts the other way, because, if necessary, New Jersey was more capable of assuming an additional financial burden than were most other states. See Kaden (D) (July 22, 1980) at 241-42, ELP App. at 234-35 ("By comparison [to] New York, . . . New Jersey has today almost an infinite amount of fiscal capacity"). We also discount as self-serving some rather extreme statements indicating lack of financial ability made by state officials before Congress while it was considering rail legislation, see 4 GP at P 77-79. We agree with the GPs that "public bodies would have had the strongest possible economic motivation to adopt strategies to minimize any new financial commitment to rail transportation, and to pay the absolute minimum for any properties they did buy", *id.* at 79, so attempts by state officials to convince Congress to shoulder the burden were to be expected. But we are not convinced that permitting abandonment of the passenger lines would have been part of such a strategy.

EL identified several sources of funds available to New Jersey. Debt finance would appear to be one of the more likely. The GPs note that all three major transportation bond issues proposed in New Jersey in the 1970's were defeated at the polls, 4 GP at P 149, including a 1974 proposal for $100 million for the preservation of rail lines that might have been excluded from Conrail or, if the Rail Act was declared unconstitutional, for other lines that might have been abandoned by the bankrupts. Here the GPs are

on weak footing. That proposal failed by less than a three percent margin.[232] EL argues that defeat may well have been due to a failure to explain the proposal, the credibility gap created by the continuing failure of the State transportation department to spend public transportation proceeds remaining from a 1968 transportation bond issue, and guilt by association with the accompanying $200 million highway construction bond program that was defeated by a substantial margin. ELP at 47 n.41; Cahill (S) (Oct. 15, 1980) at 8. In addition, in the absence of the Rail Act the prospect of abandonment of these lines would have appeared a far more realistic possibility than it did at the time of the actual 1974 bond proposal. The GPs' primary response is to note that the legislative findings made at the time of this bond issue were similar to those EL hypothesizes would have been made in the absence of the Rail Act. 4 GP at P 149 & n.60; 2 GPRB at K 34. This point is nonresponsive to some of EL's allegations and is simply unpersuasive on the facts. The existence of a "whereas" clause in the legislative act referring to loss of essential services, especially when coupled with references to federal support under the Rail Act, is simply no substitute for the facts as they would have been perceived by the public in the absence of the Rail Act, when abandonment of the spine, EL commuter lines, and additional properties otherwise would have been imminent.[233]

Much of the GP's attack on other suggested revenue sources is based upon the conclusions of First Boston relating to the impact of financing acquisition with general obligations bonds. EL claims that First Boston considered a narrow range of alternatives, whereas in another study First Boston had noted the existence of many more. ELP at 32 & N.27. The GPs reply that general obligation bonds were the focus of the inquiry because they have the minimum impact of any funding source—which they claim was one of the conclusions of First Boston's earlier study that had considered other options, 2 GPRB at K 21-22. Although persuasive, this cannot substitute for a more detailed

investigation of alternatives. One might well conclude that general obligation bonds would have been the State's first choice. But that does not rule out all other possibilities in the event that New Jersey deemed it wise to spread the cost of the acquisition among a variety of funding mechanisms.[234]

EL also alleges that some funds could have been diverted from approximately $100 million that remained unspent from the previously noted 1968 transportation bond issue. The GPs' first reply is that "it would have made no sense" to have used the funds in this manner because nothing would have remained to make improvements that had been promised to voters for years. 2 GPRB at K 35; see also 6 GP at U 64-65. This is a "patently ridiculous" reply, since as EL points out, if the lines were not purchased there would have been no railroads left to improve. ELP at 45-46. Of course, the funds were needed for buses as well, 2 GPRB at K 37, and some were eventually spent there, Cahill (S) (Oct. 15, 1980) at 7, but in the absence of the Rail Act it seems likely that funds originally intended for rail improvement would have been available if necessary to finance rail passenger acquisition rather than being fully diverted to finance the acquisition of new buses.

It might appear that no income tax revenue would have been available to finance the purchase of the passenger lines, given that it took a number of years for New Jersey to enact its state income tax in response to the added financial requirements for the state school system after *Robinson* v. *Cahill*, 62 N.J. 473, 303 A.2d 273, *reargued*, 63 N.J. 196, 306 A.2d 65, *cert. denied*, 414 U.S. 976 (1973); see 4 GP at P 145-46. Yet former Governor Cahill's remarks, Cahill (S) (Oct. 15, 1980) at 6, that there was no real crisis in the interim years and that the income tax did pass shortly after the court ordered the schools closed in the summer of 1976 seem quite persuasive. The question here is only whether the state income tax would have been available to help avert a crisis in the absence of the Rail Act, and again there is reason to believe that it would. *Id.* at 6-7.

EL also makes reference to legislation introduced in 1973 to consolidate the State's toll roads, under which revenues made available from increased tolls could supposedly have financed between $550 and $800 million in new bonds. ELP at 39-43. EL asserts that this specific proposals is one way that acquisition could be financed with less credit impact than general obligation debt. *Id.* at 42 n.39. The GPs respond that this was one of many pieces of transportation legislation not enacted at the time and that the legislation eventually enacted in 1979 did not link this revenue source to the acquisition of transportation facilities. 2 GPRB at K 30 & n.47. Of course, in 1979 the State did not face the rail crisis it might have faced years earlier in the absence of the Rail Act. The GPs are more persuasive in noting that the toll consolidation proposal "is just another way to raise taxes", 2 GPRB at K 31, although it is not necessarily the case that opposition to increased tolls would have been as strong as that to imposing the State's new income tax at a higher level to cover the costs of acquiring rail lines.[235]

A final major funding source relied upon by EL is the use of federal funds, including the application of funds from the Urban Mass Transportation Act (UMTA), Federal-Aid Highway Act (FAHA) and, in particular, the Federal Aid-Urban System program (FAUS) under the FAHA, and revenue sharing. As a threshold argument, the GPs contend that consideration of this option amounts to allowing the Ts to benefit impermissibly from an alternative long-term federal response to the rail crisis. We reject the GPs' objection because the federal funds at issue are not part of a federal response directed at the rail crisis. These programs were all in place prior to the Rail Act. Furthermore, the scope of each program extends far beyond rail services formerly conducted by private railroads. If EL depended upon increased funding of these programs resulting from the rail crisis we would reject their claim, but we do not understand it to rely upon any such increases. The GPs also would have us reject this

option because of the need for project approval by federal officials. 1 GPRB at B 23 n.28. Yet such approval, to the extent it is consistent with preexisting legislative mandates, cannot be cast aside as an alternative federal response any more than various actions of the ICC and Congress posited by the GPs both in this[236] and earlier[237] phases of the case can be.

EL offered evidence indicating that New Jersey would have access to $400 million in UMTA funds and that there were $80 million of unobligated FAUS monies, the latter amount increasing at a rate of $50 million annually. ELP at 55-56. While acquisition of existing properties was accorded a low priority under UMTA policy, in the context of possible abandonments those priorities probably would have changed dramatically. This is not to deny that the limited federal money was substantially less than New Jersey's transportation funding needs at the time. See, *e.g.*, Kaden (D) (July 23, 1980) Ex. 39 at 6. Moreover, as the GPs note, because these would not be a new source of funds, their use would be viewed by the legislature as similar to using other State revenues. 2 GPRB at K 27-28; see Tennyson (D) (March 19, 1980) at 116, 31 GP Supp. App. at 677. The difficulty in using funds from the highway acts to finance acquisition of rail lines, see 2 GPRB at K 25-26 & nn.37-38, supports essentially the same proposition. But once again the GPs have failed on the ultimate issue. All the Ts need to establish as to federal funding sources is that in the absence of the Rail Act the State could have marshalled sufficient resources to meet what would have been one of its highest priorities. The availability of federal funds undoubtedly would have assisted New Jersey in purchasing the Ts' properties.

The only significant uncertainty is which sources in fact would have financed New Jersey's takeover of the passenger lines in the absence of the Rail Act. That is an issue we need not decide. There can be little question that New Jersey would have taken the concededly difficult and painful course of sacrificing some

expenditures on other programs and increasing the overall financial burden on its citizens to prevent the rail crisis from becoming even more unpleasant.

4. *Pricing*

We find that the prices public bodies would have been willing to pay in the alternative scenario would have been negotiated with reference to the value of EL's next best alternative. The GPs devote substantial efforts to establishing this pricing principle, see, *e.g.*, 4 GP at P 7-10, 66-242, and note that it was endorsed as the likely course by testifying public officials from all the affected states, 4 GP at P 10-11; 2 GPRB at K 10-13; Cahill (S) (Oct. 15, 1980) at 10, evidence that is most probative since the relevance of pricing theories is dependent upon the extent to which "particular prospective buyers would in fact have given weight to them", *CMV Opinion*, 445 F.Supp, at 1047. But the dispute for the most part is not so much over the principle itself as over its application to the alternative scenario, see, *e.g.*, ELRB at 287-88. For the passenger lines, the Ts concede that the next best alternative would have been liquidating the property for nonrail use. Thus, most pricing arguments begin with a base price of X, and argue for premiums and deductions from this as yet undetermined figure on the basis of the value of the hypothesized sales to and the relative bargaining positions of the Ts and the public bodies.

(a) *Erie Lackawanna's Claim for a Premium in Excess of X*

EL suggests that New Jersey would have paid in excess of X in order to avoid having to condemn EL's lines. One proffered motivation is that New Jersey would have sought to avoid the litigation costs incident to condemnation proceedings. This argument ignores what EL's own witness admits: similar costs would have been entailed for the condemnee. Shannon (D) (May 23, 1979) at 472-73, 18 GP Supp. App. at 270-71; Netzer (S) (Nov. 1, 1979) at 33-34. As a result, this consideration has

a neutral effect in that it gives both parties the same incentive to avoid condemnation.

Altogether different is EL's conjecture that New Jersey would fear a condemnation award in excess of X. Specifically, EL argues that a New Jersey court would award not merely salvage value for its passenger lines—approximately $104 million according to EL—but an additional "premium" consisting of $4.9 million for going concern value[238] and $5.7 million for the difference between gross and net liquidation value as well, Shannon (S) (EL) (Dec. 31, 1978) at 92—or, at least, that New Jersey would have had sufficient fear of this that it would have paid the relatively modest premium claimed by EL.

We see no basis for thinking that New Jersey would have feared an award based on gross liquidation value. Shannon conceded he knew of no case awarding both "gross liquidation value plus a going concern value premium." Shannon (D) (May 24, 1979) at 606-07, 18 GP Supp. App. at 284-85. In fact, we have been unable to discern the reasoning upon which EL and Shannon rely for the portion of EL's claim for the excess of gross over net liquidation value. If the argument is, as we suppose it to be—that since the condemnor would not dismantle, the cost of dismantling should not be taken into account—it runs afoul of the principle that the condemnor need pay only the condemnee's next best alternative, to wit, dismantling with its attendant costs.

EL's claim for a premium based upon the going concern value of its passenger lines is based upon two New York precedents, *In re Port Authority Trans-Hudson Corp. (PATH)*, 20 N.Y.2d 457 (1967), *cert. denied*, 390 U.S. 1002 (1968), and *In re Fifth Avenue Coach Lines, Inc.*, 18 N.Y.2d 212 (1966), *appeal dismissed*, 386 U.S. 778 (1967). *Fifth Avenue Coach* is readily distinguishable since, there, going concern value was awarded because the appellate court found that only the condemnor's stringent rate regulation had prevented the condemnee from operating at a profit. No such circumstances are present here. By contrast, *PATH* permitted augmentation of the award based

upon going concern value in the case of an unambiguously unprofitable enterprise, although the basis for the court's generosity remains somewhat of a mystery. The only apparent explanation is that the motivation for the court's approval of valuation based upon original cost less depreciation—to avoid an award reflecting an excessively low scrap value (zero in the case of the tunnel properties)—was extended to permit a going concern value premium. Here X will presumably be substantial.[239] The GPs' arguments indicating that earnings values from the EL's main freight lines are in part dependent upon continuing its passenger lines in rail use, see pp. 231-33, *infra*, further distinguish *PATH*.

Quite apart from these distinctions we would be hesitant to conjecture a condemnation premium based on these New York cases. We have previously expressed our disagreement with *Fifth Avenue Coach, CMV Opinion,* 445 F.Supp. at 1022, as well as with the going concern value holding of *PATH, CMV Opinion,* 445 F.Supp. at 1037 n.54, and indicated how Justice Cardozo's opinion in *Roberts* v. *New York,* 295 U.S. 264 (1935), relied upon by both the majority and dissent in *PATH,* was unhelpful in assessing its merits, *CMV Opinion,* 445 F.Supp. at 1028-29. Rejecting any going concern value premium above a base award of X for a losing operation seems most in accord with previous pronouncements on the question. This is true even when the claim for going concern value is not a percentage of the physical values, a position rejected in *PATH* itself, 20 N.Y.2d at 471-72, see also *Galveston Electric Co.* v. *City of Galveston,* 258 U.S. 388, 393-96 (1922) (claim of confiscatory rate), but costs of the sort claimed by Shannon that would in fact be incurred in inaugurating operations. The reason is the same as that for rejecting gross liquidation value. The condemnee is entitled only to the value of its next best alternative, to wit, sale for scrap; trained personnel, operating records, etc., would have had no value in such a sale. As said in the *New Haven Inclusion Cases,* 399 U.S. 392, 482 (1970), a hopelessly losing railroad cannot be treated

"as a liquidating enterprise with respect to certain items and as an operating railroad with respect to others, depending on which happens to yield the higher value." See also *Kimball Laundry Co.* v. *United States*, 338 U.S. 1, 9 (1949); *New York, New Haven & Hartford R.R.* v. *United States*, 289 F.Supp. 418, 435 (1968).

This line of decisions is particularly important because a New Jersey court would not be bound by the New York decisions. While technically the New York Court of Appeals in *PATH* applied New Jersey law to the condemned property in New Jersey, all the court had to say on that score was that New Jersey law was similar to the general rule followed in New York and in the federal jurisdiction and that the case before it was *sui generis*, rendering it impossible to make with certainty any statements predicting the reaction of the New Jersey Supreme Court. No New Jersey cases following *PATH* have been cited to us and we are not aware of any. Thus, there is no good reason to take the going concern value portion of the *PATH* opinion as indicative of what New Jersey courts would decide New Jersey's own law to be in a condemnation of the Ts' passenger lines. And there can be little doubt that public officials would not have paid such premiums by way of settlement for fear that a New Jersey court would have followed the going concern value holding of *PATH*. See, *e.g.*, Stangl (S) (Nov. 1, 1979) at 28-29; Stangl (D) (Mar. 25, 1980) at 419-20 (New Jersey), 19 GP Supp. App. at 743-44; Tennyson (S) (Nov. 1, 1979) at 5, 9-10 (Pennsylvania); Schuler (D) (Apr. 29, 1980) at 253-54 (New York), 19 GP Supp. App. at 786-87.[240] We thus need not rule on the GPs' argument that for this court to recognize a premium based upon a state court's decisional law that is in conflict with federal condemnation law would violate principles of federal supremacy.

Finally, EL refers to some past public acquisitions of railroad property as a basis for its claim that New Jersey would have paid some premium over X. Rather than present any substantial testimony concerning these transactions on its own, EL relied

almost exclusively upon evidence offered by PC, and advanced by R after PC settled, in support of its claim for premiums 50 percent in excess of X for publicly acquired passenger lines. See ELP at 67 n.60 (LIRR) (citing Ronan and noting "other transactions referred to by him"); ELRB at 28 & n.24 (Rutland Ry.), citing 3 CRA (S) (Dec. 1, 1978) XIV at 1-45. This evidence includes a massive study performed for PC by the Charles River Associates (CRA) of historical transactions involving the acquisition of rail properties by public authorities. This was supplemented by the testimony of William Ronan, who, beginning in 1959, held a variety of high transportation positions, mostly in the State of New York. Although we agree with the Ts that information concerning past public acquisitions, properly applied, can provide useful guidance in predicting actions of public bodies in the alternative scenario, we find the Ts' evidence gives no support to their claims for premiums.

The CRA Study examined fifteen negotiated acquisitions by nonfederal public bodies of rail properties for continued rail use. The study calculated the consideration received by the railroad in each transaction and compared it with independently determined measures of "common basis".[241] Implicitly, the Ts ask that we equate the latter measure with X for the purposes of this litigation, with the result that the ratio of consideration to common basis would represent premiums actually paid.[242] "Consideration" was defined to include all benefits to the railroad that were intended as part of the agreed compensation for the conveyed property; thus it was not restricted to the cash actually paid, but included relief from operating deficits, tax relief, trackage rights, and any other concessions made by the public body. In 9 of the 15 transactions, consideration thus defined exceeded common basis.[243] The GPs criticized this study at great length, see 9 GP at App. X 1-138; 2 GPRB at N 20-29. We find it unnecessary to consider all the GPs' criticisms because we find a number of them sufficient to reject the study outright.

Appendix H

The GPs' analysis of the CRA Study falls into two categories: general methodology and reliability of execution. Defects identified in the latter category as a result of the GPs' devastating cross-examination of CRA witnesses are alone sufficient to destroy all credibility of CRA's evidence. These comprised substantial inadequacies in document collection[244] and failure to interview most of those involved in the transactions they studied.[245] The latter is particularly important given that CRA's methodology was to determine the value of benefits intended as compensation as perceived by the negotiating parties at the time of the transactions. It also appears that their investigative technique was at times most haphazard.[246] Even more troubling is that when conflicting information was received, that unfavorable to the Ts' desired conclusions was sometimes ignored.[247] CRA also relied upon doubtful legal conclusions wholly beyond their expertise.[248]

A substantial portion of the consideration received in the transactions as measured by CRA was the cash flow gain to the railroad due to relief from future operating losses.[249] This was calculated by the gains—measured by operating loss, or amount received by the railroad in the transaction under service contracts—typically for the year of the transaction and multiplying by ten to reflect the assumption that absent the transaction the operating burden would have continued well into the future. Even if we were to accept this approach, CRA's computations under it are seriously flawed. In one case, the benefit was determined by calculating the avoided costs of passenger service without subtracting the revenues derived from that service. See Lamond (D) (June 7, 1979) at 87-89 (PRSL), 13 GP Supp. App. at 356-58; 2 CRA (S) (Dec. 1, 1978) at VII 68. When service contracts were part of the transaction, CRA did not deduct the cost to the railroad of providing the service. On at least one occasion, the base figure, which in turn was inflated by the multiplier of ten, was grossly in excess of that used contemporaneously by the transferring railroad.[250] In other transactions,

CRA deemed past operating subsidies[251] and subsidies totally unrelated to the transaction[252] as part of the consideration.

Support for CRA's use of a multiplier of ten is also highly dubious. For the multiplier to be that high, assuming a 6 percent interest rate, operating losses would have had to be expected to continue for at least sixteen years. CRA (S) (Dec. 1, 1978) at 54-56. Yet there is no apparent basis to assume that losses would have continued for so long. The public bodies acquired the properties only after the prospect of such deficits made discontinuation of passenger services a serious possibility. See Nathan (D) (Apr. 15, 1979) at 379-80, 15 GP Supp. App. at 215-16. Available evidence in a number of transaction indicates that losses would have continued for only a few years,[253] suggesting that a multiplier closer to two might have been in order.

More disturbing is evidence suggesting that the multiplier of ten was not merely an arbitrary choice but rather a figure derived after the fact to ensure that CRA's study reached conclusions favorable to the Ts. It appears that CRA had originally used a multiplier of 4.31, based upon the assumption that operating losses in the absence of the transaction would have had a five year duration. It was admitted that the decision to move to a factor of ten might have been made after CRA began receiving the common basis numbers against which their consideration figures were to be compared. J. Boyd (D) (June 7, 1979) at 376 (Methodology), 9 GP Supp. App. at 165. CRA did not indicate any new information upon which this change was based, see J. Boyd (D) (June 19, 20, 1979) at 283-84 (West End), 446-47 (Harlem-Hudson), 9 GP Supp. App. at 220-21, 238-39; LaMond (D) (June 7, 1979) at 15, 71-72 (PRSL), 13 GP Supp. App. at 346, 354-55; Wise (D) (June 8, 1979) at 91-103 (Cleveland), 21 GP Supp. App. at 701-13, and the GPs are persuasive in refuting Boyd's contention that the original 4.31 factor was merely a placeholder, later to be replaced by some other figure that was being independently determined.[254]

We also find the theory offered to justify the inclusion of avoided future passenger deficits unpersuasive. Where consideration was based upon payments for service contacts, it is consideration for those services, not for the properties conveyed. See Nathan (S) (Nov. 1, 1979) at 41; Nathan (D) (Apr. 18, 1980) at 872-73, 15 GP Supp. App. at 232-33; Netzer (S) (Nov. 1, 1979) at 16-17; Prince (S) (Nov. 1, 1979) at 9 (West End), 14 (Harlem-Hudson); Salvucci (S) (Nov. 1, 1979) at 3 (B&M). This much was virtually conceded upon cross-examination. J. Boyd (D) (June 7, 1979) at 454-56 (Methodology), 9 GP Supp. App. at 192-94; Ronan (D) (July 9, 10, 1979) at 248, 337, 17 GP Supp. App. at 501, 541. In the alternative scenario, public bodies would have had to make additional payments for these services, whether provided by themselves or contracted to other operators. See Ronan (S) (Dec. 1, 1978) at 92 (MTA and the Connecticut Transportation Authority "[s]urely" would not have paid these "staggering" amounts of future operating losses in cash for the Harlem-Hudson and West End properties); Ronan (D) (July 10, 11, 1979) at 337, 511, 586, 17 GP Supp. App. at 541, 586, 611. Finally, even if such consideration were significant, it would be of no help to the Ts' claims for premiums because the Rail Act has already provided equivalent compensation by relieving them of future operating deficits. To the extent the actual cash paid in historical transactions must be augmented to reflect this benefit, so the cash due from the federal government need not cover the future operating losses that the government has already taken over. In fact, the Ts' theory suggests that the GPs would have been entitled to claim the benefit of relief from anticipated future passenger operating losses as an offset to the awards claimed by the Ts. *Cf.* p. 236, *infra* (special benefits doctrine).

CRA's use of common basis data is also questionable. CRA makes no claim that these valuations were based upon the beliefs of the parties at the times of the transactions. See CRA (S) (Dec. 1, 1978) at 30; J. Boyd (D) (June 6, 1979) at 180-81; 223-24 (Methodology), 9 GP Supp. App. at 96-97, 122-23. These

beliefs are important in predicting public body actions in the alternative scenario because prices can only be based upon X as perceived by the parties to the negotiations, and not upon some other figure determined by hindsight. Throughout its study, CRA explicitly used calculations differing from those of the parties and included elements not known to the parties, particularly in connection with appraisals of common basis. See, *e.g.*, J. Boyd (D) (June 6, 7, 1979) at 185, 192, 329 (Methodology), 9 GP Supp. App. at 98, 103, 146; Gillan (D) (Apr. 25, 1979) at 343, 9 GP Supp. App. at 777; 2 CRA (S) (Dec. 1, 1978) at I 35-36; Caust-Ellenbogen (D) (July 3, 1979) at 71-74 (SIRT), 9 GP Supp. App. at 481-84; Nathan (S) (Nov. 1, 1979) at 9; note 251, *supra*, p. 226, *infra*, (appraisals in B&M and LIRR transactions). In addition, some of the common basis values used were contradicted by available appraisals.[255]

CRA's analyses of the LIRR and B&M transactions, which were cited by EL, exemplify some of CRA's errors. First, the actual cash paid in both transactions exceeded only slightly the so-called common basis for these properties. The figures for cash paid and common basis were $39.5 million and $37.5 million for the B&M, CRA (S) (Dec. 1, 1978) at 154, and $65 million and $63 million for the LIRR, *id.* at 119. Much of the "excess consideration" in the B&M transaction was attributable to the value of operating subsidies which a Massachusetts official denied were intended as compensation for the property conveyed; rather the money was paid for services B&M had contracted to provide. Salvucci (S) (Nov. 1, 1979) at 3. Moreover, in determining the common basis figure for B&M, CRA ignored an appraisal of two-thirds of B&M's conveyed real estate at a value over fifty percent higher than the figure CRA used for the whole. See Seymour (S) (Dec. 1, 1978) at 78; 9 GP at App. X 130. For the LIRR, Ronan's prior statements in 1967 and 1974 indicate that the cash paid constituted the whole cost to the MTA. Ronan (D) (July 9, 1979) Ex. 4 at 52; *id.* Ex. 6 at 964-65 (also indicating that "the real estate alone was worth more than the purchase price we

paid"). In addition, the common basis figure relied upon for comparison in the LIRR transaction is quite suspect.[256] Finally, as to the Rutland acquisition, contrary to EL's indication that a premium was paid, see ELRB at 28 n.24, no premium could be calculated, because PC consultants never came up with a common basis figure.

In short, we find CRA's method inapposite for determining whether any premium would have been paid by public bodies in the alternative scenario and conclude that in any event their data collection and computations are wholly unreliable. In fact, if one were to recompute the measures of consideration and common basis based upon the unrebutted criticisms of the GPs, the results would indicate that public bodies in these historical transactions paid less than common basis. However, especially since the underlying data is so unreliable, we accept the GPs' invitation to ignore CRA's study altogether.

Ronan's testimony purportedly provided independent support for the 50 percent premium. He asserts that the amount public bodies would have paid for the Ts' lines would have been dependent upon their social value: the least important would be valued at scrap, but those for which abandonment was completely beyond the realm of possibility would have brought a higher price. Ronan (S) (Dec. 1, 1978) at 79-80. He claims to find empirical support for his position in some of the historical transactions studied by CRA, and reasons that the public would have had no choice but to pay significant premiums because of the fear that a condemnation award would have been even higher. We do not, however, believe that Ronan's testimony adds anything to CRA's study or to EL's case for a premium based upon the desire of public bodies to avoid condemnation.

It is unclear how Ronan came to choose his 50 percent figure for the premium in excess of X. Neither he nor R contends that CRA is the source of this figure, and he did not perform his own study of appropriate values for consideration as compared to X for these historical transactions. He asserts that "[e]xperience,

. . . reinforced by CRA's analysis of the earlier transactions, demonstrates that the difference between the consideration paid and any measure of 'liquidation value' grows with the importance of the particular line to the public", Ronan (S) (Dec. 1, 1978) at 79, but does not provide any estimate of the value to the public in any of the transactions for which he noted CRA's ratios of consideration to common basis or even a hint of a reason suggesting that those transactions for which CRA found larger ratios involved more important properties. Ronan (D) (July 10, 11, 1979) at 459-64, 626-27, 632-33, 17 GP Supp. App. at 573-78, 624-25, 627-28. It is impossible for us to accept so large a premium based only upon very general theorizing followed by what seems to be little more than a guess.[257]

Ronan's theory seems to offer little more than repetition of EL's claim for a going concern value premium. His theory that premiums would vary with the importance of the lines is based upon his assumption that "importance is what establishes the bargaining position of the parties". Ronan (S) (Oct. 15, 1980) at 100. He relies heavily upon the notion that the public would have been under duress, and that the railroads thus would have had the ability to hold out for large premiums. See Ronan (D) (July 9, 10, 11, 12, 1979) at 63-64, 152, 301, 319-20, 325-26, 376, 641-42, 1048, 17 GP Supp. App. at 451-52, 485, 518, 526-27, 532-33, 559, 636-37, 772. Accepting as true the proposition that states would have been forced to condemn the Ts' passenger properties, a contention we reject at p. 234, *infra*, it is still unclear how the fear of having to pay a condemnation award somewhat higher than X would result in a 50 percent premium being paid in negotiations since the anticipated condemnation award places a ceiling upon what a public body would willingly have paid. Unlike EL's argument that condemnation might produce an award for going concern value based upon *PATH* and *Fifth Avenue Coach*, see pp. 219-21, *supra*, Ronan's theory of an award based upon value to the public lacks even a colorable claim to support in condemnation law. See, *e.g.*, *Boston Chamber of*

Commerce v. *Boston*, 217 U.S. 189, 195 (1910); *United States* v. *Chandler-Dunbar Water Power Co.*, 229 U.S. 53, 80-81 (1913); *CMV Opinion*, 445 F.Supp. at 1013-16.

All that remains is Ronan's claim based upon historical transactions. R emphasized in its opening brief, RP at 39, 41-42, that Ronan's theory was amply supported by CRA's study. However, at other points and in reply, they emphasize Ronan's independence from CRA, RP at 64, RRB at 49-50. But, with one exception, we are not told on what other historical evidence he did rely. In the one transaction in which he was involved, his contemporaneous statements contradict CRA's conclusions. See p. 225-26 & n.257, *infra* (LIRR). Finally, he conceded that if CRA's ratios had come out differently, he would have had to reconsider his conclusions. Ronan (D) (July 10, 11, 12, 1979) at 276-80, 296-97, 603-06, 1028-29, 1068, 17 GP Supp. App. at 504-05, 516-17, 616-19, 769-70, 775.

In rebuttal to Ronan, the GPs offered the testimony of Edson Tennyson, Deputy Transportation Secretary for the Commonwealth of Pennsylvania from 1972 until 1979. Tennyson originally testified for North Penn, supporting its claim that public bodies would have acquired its passenger properties. At deposition, North Penn did not permit Tennyson to answer questions pertaining to the prices Pennsylvania would have paid. Tennyson (D) (Apr. 3, 1979) at 17, 26-27, 45, 48, 54, 20 GP Supp. App. at 711-13, 720-21, 724. When testifying for the GPs, however, he stated that he had thus far presented only half of his story and volunteered to appear as a GPs witness, without remuneration, in order to make the record complete, Tennyson (D) (Mar. 19, 1980) at 37, 20 GP Supp. App. at 731. Given his chance, Tennyson flatly stated that Pennsylvania would not have paid more than X for the passenger properties. Tennyson (S) (Nov. 1, 1979) at 4-5, 8-12.

The final attempt to rescue the claimed premium is R's evidence concerning Philadephia's offer of $472,441 for an easement over 3.5 miles of R's Chester Branch. But the circumstances

surrounding this acquisition are not comparable to those that would have prevailed in the alternative scenario where R and North Penn's passenger lines would have been acquired. Most notable is that the Chester Branch was not a passenger line. Moreover, there is no evidence indicating an estimate of X for this segment, so we cannot determine whether any premium was involved. Using the per mile figure derived by R from this example, the value of all their proffered passenger lines comes to $13.7 million, which is less than 25 percent of the $61 million claimed for their passenger properties and less than 35 percent of their $41 million estimate of X (without premium) for those lines. Finally, there is no evidence indicating the basis upon which the acquisition figure was derived by the parties to the transaction.

The GPs also played the game of basing conjectures of what would have happened in the alternative scenario on evidence of past transactions. They refer to the 1972 Southeastern Pennsylvania Transportation Authority (SEPTA) Memorandum of Understanding whereby all the Philadelphia area passenger properties were to be leased for a period of fifty years, subject to three fifty-year renewals, for which R and PC were not to receive any cash at all. Ex. GPS-Public Bodies-175, 176. This Memorandum was approved by R's reorganization court, but on appeal to the Third Circuit, the lower court's order was vacated and remanded for further proceedings in light of the Rail Act, which had just been enacted. *In the Matter of Reading Co.*, No. 73-1631 (3 Cir. Mar. 22, 1974). The GPs offered this as support for their argument that public bodies would demand deductions from X is setting prices, see pp. 231-33, *infra*, but, since the issues parallel those discussed in connection with the CRA Study and the other transactions, we consider the SEPTA Memorandum here.

In response to the GPs' argument that only one year before the Rail Act it had been willing to give away its passenger properties, R claimed that, in that case, it had in fact received substantial consideration. The most significant alleged consideration was

the public's assumption of R's passenger operations and their attendant deficits. This claim parallels CRA's inclusion of such relief as part of consideration in their study and is subject to the same criticism. R conceded at oral argument that including this benefit as an element of value would amount to "double-counting" since the benefit is already received as a result of the proffered acquisition by the public in the alternative scenario. Tr. at 506, see pp. 224-25, *supra*. Moreover, R's claim that it would have been able to abandon its passenger operations, 2 RF at 214-305, undermines the value of this alleged element of consideration.

A second element of consideration is the free trackage rights granted to R and PC for freight use of the passenger lines covered by the Memorandum. To demonstrate the magnitude of this element, R refers to an agreement by Chessie to pay Conrail $2.2 million annually for operating freight service over what had been R's passenger properties. The GPs note, however, that this was a reciprocal agreement under which Concrail was to pay Chessie a similar sum, Tr. at 352, casting doubt on the true value of trackage rights over these properties. By contrast, at the time of the Memorandum, PC valued the trackage rights over its passenger lines at only $1.6 million annually, Ex. GPS-Public Bodies-188 at 6, an amount seriously questioned as too high by PC's creditors, Ex. GPS-Public Bodies-178 at 28. And it is difficult to square R's valuation of trackage rights with JTTs' witness Jennison's estimate that the annual charge for Philaterm's use of the terminal passenger lines, excluding the Northeast Corridor, amounted to merely $68,774. Jennison (S) (JT) (Dec. 15, 1978) at 35, 52. Finally, even if free trackage rights were in fact extremely valuable, this simply supports the GPs' claim for deductions by indicating the importance of the Ts' passenger lines for freight traffic, see pp. 231-33, *infra*.

R also asserted that retained air rights were of significant value. However, since no quantification is available and since the Ts were only to receive half the proceeds from sales of air rights

after application to commuter deficits, see 4 GP at P 200, we cannot attribute any significant value to them. We thus conclude that the SEPTA Memorandum seriously undermines the claim that Ts would have received premiums for their passenger lines, and further suggests that prices less than X would have been likely.

(b) *Government Parties' Claim for Deductions from X*

Having dismissed EL's plea for prices for its passenger lines significantly in excess of X, we now consider the GPs' claim that public body prices would instead have reflected deductions from X. The argument begins with the observation that New Jersey's purchase of EL's passenger lines would have conferred a benefit upon EL to the extent that in the sale of its main freight lines it would have been able to derive additional earnings value attributable to traffic dependent upon the passenger lines' continued existence in rail use—an earnings value hereafter referred to as "D". From this premise the GPs argue that public bodies, seeking to pay no more than necessary for the Ts' passenger lines, would have deducted D from the X of those lines to arrive at the price they would have been willing to pay.

The theory can be explored from the perspective of the Ts' contention that profitable acquirers of their freight lines would not have purchased predominantly passenger lines under any circumstances, which leaves abandonment as the only private marketplace alternative. If any T would have pursued that alternative, it would have realized the full value of X from its scrap sale, but would have lost D on the sale of its main freight lines since their earnings value would have been diminished by that amount as a result of the abandonment.[258] Thus, EL's claim that X was "the minimum price which EL would have been required to accept on a sale made in order to keep those properties in rail use", ELRB at 290-91, simply misses the point. In

essence, the GPs' argument is that a state's payment of X, without deduction, for the passenger lines amounts to a double recovery since the affected T would receive the full benefits of two mutually exclusive dispositions of its passenger lines.

It is credible that a state would have followed the pricing rule urged by the GPs, since it derives from the more general principle of paying no more than the best marketplace alternative for the Ts' lines, see p. 218, *supra*. The GPs' presentation of testimony by public officials indicating that they would have insisted upon a wide array of other deductions, 4 GP at P 13-21, and that they would have taken into account the degree to which the profitability of the Ts' main freight lines would have been contingent upon the continued operation of public body lines[259] strongly suggests that the GPs' theory is a sound indicator of what would have happened in the alternative scenario. In fact, the GPs' position is little different from that advanced by some Ts in claiming that off-segment earnings should be accounted for in determining earnings value. See pp. 286-88, *infra*.

One caveat to this analysis is necessary. The deduction from the price to be paid for a passenger line cannot exceed its X.[260] D in excess of X is, after all, simply another way of stating that earnings value, broadly defined, see pp. 40-41, *supra*, exceeds X. When that occurs, it would be profitable to include the segment in the package with EL's freight lines rather than permit it to be abandoned. To a private acquirer, a predominantly freight line and a predominantly passenger line would be viewed equivalently to the extent that each made an equivalent contribution to earnings value, so long as responsibility for passenger operations was not linked to purchase of the track. The flaw in the Ts' analysis, see, *e.g.*, ELP at 64 n.58, lies in the inarticulated assumption that passenger operations and the rail lines themselves are inseparable. See Tr. at 311, 318 (GPs). *Compare* ELRB at 270-72, 290 *with id.* at 268 n.265 (essentially conceding the point). It is not necessary in determining the value of a T's property to resolve

whether a passenger line for which D exceeds X would be privately or publicly acquired. If it would have been the former, the sale price of the freight package would not be enhanced since the T's estimates of earnings value already account for the earnings attributable to these lines; if it would have been the latter, the private acquisition price is unchanged since the lines will continue in rail use and the public simply pays zero. Of course, in considering these deductions there remains the further caveat that the proceeds from the sale of the freight lines at earnings value combined with those from sales to public bodies cannot be less than X for the entire system. Whether this point will require consideration will not be known until completion of the nonrail use phase of the case.

Determining the amount of such deductions is more complicated. The Ts at no point offered any specific evidence on the significance of D. Although the CERL Study found that 44 percent of the freight revenues on the three T's lines derived from traffic exclusively served by public body lines, Waldner (S) (Jan. 30, 1980) at 11,[261] it did not distinguish between the predominantly passenger and predominantly freight lines. Yet there can be little doubt that the values of D for some passenger lines would have been quite significant. Shannon indicated that freight traffic on about half of the New Jersey suburban lines was "substantial". Shannon (D) (May 21, 1979) at 46-47. Figures submitted by both the GPs and EL in response to a letter from the court dated August 28, 1981, Sp. Ct. Rep. N 36850, discussed at pp. 237-44, *infra*, confirm this. We reserve consideration of the magnitude of the deduction applicable to particular passenger lines until after our discussion of bargaining between public bodies and the Ts.

(c) *Bargaining with Public Bodies*

Public bodies would have entered negotiations with the Ts for their passenger lines with two objectives in mind: avoiding the loss

of important rail service and keeping the purchase price to a minimum, see Ronan (D) (July 10, 11, 1979) at 305, 362-66, 631, 17 GP Supp. App. at 520, 551-55, 626. The latter desire would have been particularly acute given the large amounts at stake, the financial difficulties facing state governments at that time, and the publicity that would have accompanied any such transaction. See pp. 211-17, *supra*; 4 GP at P 96-102. The Ts' objective would have been to maximize the aggregate return from the sales of their property: the combination of the prices to be received from sales of their freight lines to profitable railroads and of their passenger lines to public bodies. We find that under these circumstances the public bodies would have had a strong upper hand, with the result that successful negotiations, avoiding the need for condemnation, would have yielded prices of X minus D for the Ts' passenger lines. *Cf.* pp. 41-42, *supra* (bargaining with only one bidder).

The source of the Ts' weakness in the bargaining is the dependence of the sales of their freight lines to profitable railroads upon the disposition of their passenger properties. See, *e.g.*, Altshuler (S) (Nov. 1, 1979) at 21, 26-27 (prospective solvent acquirers would have pressured Ts to dispose of public body lines rapidly to assure earnings on main freight lien acquisitions); Netzer (S) (Nov. 1, 1979) at 8-9, 41-42. To the extent that earnings on the main freight lines did not depend upon the continued operation of any particular passenger line, the deduction issue is moot since the D for such passenger lines would be zero. Conversely, the greater the applicable deduction, the greater by definition is the dependence of the freight sales upon public acquisition of the passenger lines and the weaker would have been the Ts' position in bargaining with the states.[262]

The only way a T could have extracted more from a public body would have been if it could have effectively threatened to abandon its lines and thus disrupt the state's commuter operations. But the Ts would have been unable to mount a persuasive threat for a number of reasons. First, such a threat with respect to a line

contributing significant earnings value to the main freight lines would not be credible on its face. Witnesses for both the Ts and the GPs agreed that cessation of operations by a T for any substantial period of time would have been irreversible.[263] It might be argued that similar damage would be inflicted on the public, but the public is in a much different bargaining position. Although harmful to the public, such action would amount to suicide for the T, and public bodies were well aware of this.[264] EL's witness Shannon had previously counseled EL against using the threat of shutting down in order to obtain bargaining leverage. Shannon (D) (May 23, 1979) Ex. 6 at 7.

In addition, the state would have realized that any particular T would have been a one-time player at the bargaining table. Thus no T could have hoped to gain from any enhanced credibility in future negotiations that might have resulted from actually carrying out the threat.[265] By contrast, the state is a repeat player that must bargain with other Ts as well as with other entities in related future situations, such as, for example, possible acquisitions of bus companies, Cahill (S) (Oct. 15, 1980) at 11, railroads not yet bankrupt, and a wide variety of other enterprises. Thus it has much to lose from giving in to any unreasonable demands of a T. See Stangl (D) (Mar. 25, 1980) at 420, 19 GP Supp. App. at 744.[266]

Finally, even if a T could mount a persuasive threat and overcome any ICC barrier to acting upon it, a state would have been able to resort to quick-take condemnation powers. See note 221, *supra*. Of course, condemnation was at the state's option. The Ts claim that a negotiated solution would have been most likely for a number of reasons. See, *e.g.*, ELRB at 291 n.294 (arrangement of financing easier for state with negotiated sale).[267] But the GPs are correct in noting that condemnation would be available, and, if the Ts held out for excessive prices, likely. Schuler (S) (Nov. 1, 1979) at 14 (referring to PC's Remsen line: ". . . I was convinced that, as a public official, it would have been irresponsible for me to offer any more to Penn Central than they

could have realized absent a state acquisition"). All that remains to be determined is what condemnation award would have been most likely if that course had been taken.

We have already dismissed the Ts' claim that premiums above X would have been awarded by a condemnation court, see pp. 218-21, *supra*. Here we note that it would have been appropriate, and thus reasonable to expect, that a condemnation court would recognize the GPs' theory for deducting D from X in determining an award. The reasoning is a simple extension of the principle of permitting offsets for special benefits.[268] The justification for the special benefits doctrine transcends mere metaphysics. It recognizes that the purposes behind the constitutional requirement of just compensation are both consistent with and served by the rule. See *Bauman* v. *Ross*, 167 U.S. 548, 584 (1897). It is consistent with providing justice to the condemnee since the purpose of compensation is to ensure that the one affected is not left worse off by the government's taking. *Id.* at 574. By hypothesis D is a measure of the gain in price from the private sale of the Ts' freight lines afforded by continued operation over the passenger lines, and is thus a correct measure of a deduction from an award for the passenger lines.[269]

It would be anomalous to consider "mere use of a railroad [to] be a special benefit if the owner of the [condemned] land may connect this establishment with the main line by spur tracks or the like", see 3 Nichols, *supra*, § 8.6203[3] at 8-180 to -181 & n.42, but not to consider the use of a railroad a special benefit if the owner of the taken property may connect its entire freight system directly with the now public railroad. Just as in more traditional applications of the special benefits doctrine, this benefit is not one generally received by a group of property owners. In this case the special benefit is unique to the Ts as they benefit from the taking in a different and far more significant way than does any member of the general public. And since the requirement of just compensation includes justice to the public, see *Garrison* v. *New York*, 88 U.S. (21 Wall.) 196, 204 (1875); *Searl*

v. *School District No. 2*, 133 U.S. 553, 562 (1890), a condemnation court would feel compelled to permit the deduction, which has the effect of dispersing widely the social benefits from the taking.

In order to avoid misunderstanding, we repeat two previously highlighted limits to the implications of our conclusions. First, the deduction urged by the GPs is limited by the actual contribution the publicly acquired passenger lines make to the Ts' sales. Second, a corollary to this proposition is that deductions would not be permitted to bring the total for all the Ts' properties below X for their entire system.

(d) *Magnitude of the Deductions*

The theory upon which the deduction argument is predicated, viewed in the context of the bargaining process just described, provides the basis for estimating the magnitude of deduction from X that would have been demanded by a public body in the alternative scenario. As we noted previously, see p. 233, *supra*, however, the briefs indicated only the qualitative significance of D, without providing the data necessary for computations. As a result, the court sent a letter on August 28, 1981 to counsel for EL and GPs, Sp. Ct. Rep. N 36850, requesting more focused information based upon materials in the record. The responses to this letter provide data indicating the total freight traffic moving over each of EL's predominantly passenger segments, broken down into the number of carloads originating or terminating on the segment, the number interchanged on the segment, and the number simply passing over it. The data also indicate how much system revenue derives from cars moving over each of the segments for each of the hypothesized EL-LV acquisition packages. Finally, the GPs performed some simple computations to indicate the earnings value that would be lost on the EL-LV system in the absence of traffic that moves over EL's predominantly passenger lines.

The parties' replies exhibited substantial agreement as to the answers to the court's questions; disagreement focused upon the implications of those answers. See, *e.g.*, Reply of the Erie Lackawanna Trustees to the Government Parties' Response to the Court's Letter Dated August 28, 1981, Concerning "Predominantly Passenger Lines" in the North Jersey Terminal Area (Sept. 21, 1981) at 1-3 Sp. Ct. Rep. at N 37082-4 (hereinafter EL's Sept. 21, 1981 Response); GPs' Reply to EL's Response to Court's Letter of August 28, 1981, (Sept. 21, 1981) at 1-2, Sp. Ct. Rep. at N 37071-72 (hereinafter GPs' Sept. 21, 1981 Response). In particular, EL conceded that its line from Port Morris through Denville and Boonton into Croxton Yard and Hoboken (Boonton line) "was essential to the profitability of the EL-LV acquisition". EL's Sept. 14, 1981, Response at 6, Sp. Ct. Rep. at N 36894. As to the remainder of El's predominantly passenger lines, the focus of EL's argument continues to be that they are not essential for the sale of the freight lines to a solvent railroad to go through. The GPs respond correctly that this does not address their claim that these lines contributed to the earnings value of the freight lines, with consequent effect upon the price New Jersey would have paid and the trackage rights fees it would have charged. GPs' Sept. 21, 1981, Response at 6, Sp. Ct. Rep. at N 37076.

The GPs' calculations indicate that in excess of $100 million of earnings value for the EL-LV system may be due to traffic moving on EL's passenger lines,[270] figures that rival EL's claim for $103.8 million in salvage value for these lines, see Shannon (S) (EL) (Dec. 31, 1978) at 92. Given EL's concession as to the essentiality of the Boonton line, it seems quite likely that a properly computed D will be in excess of X for the Boonton line, suggesting that New Jersey would have acquired this for a price only marginally in excess of zero.

The outcome for the other predominantly passenger lines is far less certain because the corresponding D's are much smaller than for the Boonton line and because we will not have conclusive

estimates of the X for any of the passenger lines until completion of the next phase of the case. Thus we must proceed on the assumption that D will not exceed X for at least some of the lines. This possibility raises a basic methodological question which we have thus far postponed: Must D be computed segment-by-segment, or is it satisfactory to estimate a single D for the passenger lines as a whole? The latter "package" approach essentially permits excesses of D over X on some passenger lines, such as the Boonton line, to overflow onto other lines, thereby diminishing or fully negating any positive prices that would be derived under an "itemized" approach for segments having an X greater than D.

Concededly, negotiations between EL and New Jersey in the alternative scenario probably would have produced a package deal rather than several line-by-line agreements. But the most reasonable assumption is that the price for the package would reflect estimates based upon figures for each segment. This follows from the fact that if New Jersey offered a lower price based upon, for example, the package methodology, EL could have followed the option of including any lines, such as the Boonton line, for which D exceeded X, shorn of responsibility for the deficit producing passenger operations, in the sale of its freight lines to a solvent acquirer, and abandoned the rest. Simply, EL would find it profitable to abandon any *segment* for which EL did not implicitly receive a price of at least X minus D from the State.

While we conclude that we must compute D for each segment, application of this principle is complicated by deficiencies in available data. To the extent traffic could be rerouted over freight lines, or concentrated on a few of the passenger lines, EL would have bargaining leverage as to those passenger lines upon which its freight movements were not truly dependent. But there is no testimony demonstrating the feasibility of rerouting freight traffic that historically moved over EL's passenger lines, or indicating over which lines such rerouted traffic might travel. To the extent traffic cannot be rerouted, there is no evidence indicating whether it could be loaded elsewhere, or whether the most likely

alternative loading points for such traffic would be onto the EL-LV system or some other. Finally, we cannot be certain of the amount of double-counting that would be involved in examining revenue figures for different passenger segments since some of the freight traffic moved over more than one segment. To be certain that no evidence was overlooked, we explicitly inquired about the "feasibility and cost or rerouting freight traffic from EL 'predominantly passenger' lines," Court's Sept. 24, 1981 Letter, Sp. Ct. Rep. N 37187. The parties' replies demonstrate that the record is essentially silent on the question. Government Parties' Response to Court's Letter of September 24, 1981, (Oct. 7, 1981) at 3-4, Sp. Ct. Rep. N 37235-36; Response of the Erie Lackawanna and Lehigh Valley Trustees to the Court's Letter Dated September 24, 1981, Concerning "Predominantly Passenger" Lines in the North Jersey Terminal Area (Oct. 7, 1981) at 5-6, Sp. Ct. Rep. at N 37258-59.[271]

We have made every attempt to elicit all record materials relevant to determining the magnitude of D and now must make the most reasonable estimate possible from available information. The first step is to estimate the traffic that would be lost if any particular segment were abandoned. We choose a base figure that includes all originating and terminating traffic and excludes the rest. Traffic that merely passed over a segment or was interchanged on a segment is that most likely to be reroutable. In addition, considering such traffic would lead to some double-counting since in many cases it originated or terminated on one of the other segments. By contrast, limiting consideration to originating and terminating traffic makes double-counting most unlikely since movements that both originate and terminate within the small area covered by the passenger lines are negligible. See ELRB at 275 & n.273. Moreover, originating and terminating traffic cannot directly be rerouted over another EL line, so it is the traffic most likely to move by some other mode of transportation, or move over some other carrier's system, in the event that the passenger segment was abandoned. The exclusion

of overhead traffic in estimating D results in some understating of the importance of the passenger lines for main line freight earnings because not all such traffic is counted twice and because rerouting is not costless. Including all originating and terminating traffic no doubt overstates the importance of some passenger lines. But in the absence of any evidence by the Ts concerning the feasibility of rerouting no other option is available. This base figure includes virtually all traffic on some of the smaller branch lines but excludes a significant portion (although not a majority) of traffic on the major lines into Croxton Yard.

Traffic Originating or Terminating on Passenger Segments:

*EL-LV Western Acquisition**

Line	*Cars O/T***	*Total Cars*	*Ratio*
Hoboken to Port Morris	148,022	213,060	.695
Croxton to Gladstone	1,058	3,615	.293
Croxton to Suffern	47,576	67,266	.707
Suffern to Sparkill	1,231	1,273	.967
NJNYE to Nanuet	7,839	7,848	.999
Hoboken to Rdgwd. Jct.	11,252	11,401	.987
Summit to Denville	5,861	6,376	.919
Newark to Montclair	341	341	1.000
Hoboken to Ptrsn Jct.	7,355	8,682	.847

* From GPs' Sept. 14, 1981, Response, Table C, Sp. Ct. Rep. at N 36885 and GPs' Sept. 21, 1981, Response to EL at 1 n.1, Sp. Ct. Rep. at N 37071.

** Refers to originating or terminating traffic. There is some traffic that originates and terminates on EL's passenger lines. Any overstatement that results from this double-counting is insignificant since EL's intrastate freight business "was by any standard negligible". ELRB at 275 & n.273.

From these base traffic figures, we derive a revenue estimate. We simply multiply the revenue figures attributed to all traffic on each of the segments by the ratio of originating and terminating traffic to total traffic. Although it is possible that the average revenue on carloads that originate and terminate on the passenger

lines is somewhat higher or lower than the average for all carloads moving over the passenger lines, it is doubtful that any such error is significant and no evidence has been produced suggesting that there is any error at all, or providing any way to correct for any imprecision that might result.

*Revenue Loss: EL-LV Western Acquisition**

Line	*Total Revenue*	*Revenue Loss*
Hoboken to Port Morris ...	72,852,084	50,613,494
Croxton to Gladstone	454,480	133,012
Croxton to Suffern	20,969,680	14,831,467
Suffern to Sparkill	477,037**	461,298
NJNYE to Nanuet	2,701,073	2,697,975
Hoboken to Rdgwd. Jct. ..	5,015,226	4,949,682
Summit to Denville	1,117,467	1,027,207
Newark to Montclair	118,351	118,351
Hoboken to Ptrsn Jct.	2,381,465**	2,017,470

* From GPs' Sept. 14, 1981 Response, Table C, Sp. Ct. Rep. at N 36885.

** These figures are derived by multiplying the revenue figures for these lines, GPs' Sept. 21, 1981, Response at n.1, Sp. Ct. Rep. at N 37071 by .9369, which is the ratio of Western acquisition revenues, GPs' September 14, 1981, Response, Table C, Sp. Ct. Rep. at N 36885, to historical revenues, GPs' Sept, 14, 1981, Response, Table B, Sp. Ct. Rep. at N 36884, for all but the Hoboken to Port Morris line, see GPs' Sept. 14, 1981, Response at 13-14, Sp. Ct. Rep. at N 36868-69.

Finally, we must estimate the earnings value attributable to the revenue that would be lost from the abandonment of each segment. We adopt the approach used, for example, by Shannon in determining the earnings value contribution resulting from projected increases in revenue on the EL system, Shannon (S) (EL) (Dec. 31, 1978) at 49 (Western acquisition), and by the GPs in their Sept. 14, 1981 Response, at 18-21, Sp. Ct. Rep. at N 36873-76. This method multiplies the figure for the change in total revenue by a factor indicating the excess of revenue over variable cost. This is reasonable because for relatively small changes in

traffic levels over a railroad's entire system, only variable costs are affected. For example, an increase in traffic of 2 percent would increase labor, fuel, and maintenance costs somewhat, but typically would require laying new track. Similarly, if traffic were to decrease 2 percent, the number of trains, level of maintenance costs, and overhead would not decrease by a full 2 percent. By contrast, if traffic levels were to change by a large magnitude, the concomitant change in costs would be more nearly proportionate, although still not one-to-one. See generally Jennison (S) (EL) (Dec. 31, 1978) at 19; Shannon (D) (May 21, 1979) at 99, EL App. A at 221. The 60 percent variable cost-to-revenue ratio used by Shannon for changes in traffic with the Western acquisition in the range of 6 percent, Shannon (S) (EL) (Dec. 31, 1978) at 49, is persuasively defended by EL in the context of arguing that it should be applied to its projected traffic increases. See 1 ELF at 79 n.64 (indicating use of similar ratios in prior ICC decisions); see pp. 263-64 & n.293, *infra*. The revenue loss that would result from abandonment of the Boonton line, however, is significantly in excess of that range. For this segment, Jennison's cost-to-revenue ratio of 71.4 percent, developed for application to an almost 20 percent decline in LV traffic volume in a region, Jennison (S) (EL) (Dec. 31, 1978) at 18, is most reasonable.[272] We need not determine comparable figures for the Chessie Acquisition for reasons given at note 151, *supra*.

Appendix H

Annual After-Tax Earnings Loss

Line	*Earnings Loss*
Hoboken to Port Morris	$7,237,730
Croxton to Gladstone	26,602
Croxton to Suffern	2,966,294
Suffern to Sparkill	92,260
NJNYE to Nanuet	539,595
Hoboken to Rdgwd. Jct.	989,936
Summit to Denville	205,441
Newark to Montclair	23,670
Hoboken to Ptrsn Jct.	403,494

The final step is to capitalize the annual earnings value estimates. The appropriate discount rate, 9.13 percent, was derived in Part VII. The resulting values for D as are follows:

*Magnitude of Deductions**

Line	*Deduction*
Hoboken to Port Morris	$79,274,148
Croxton to Gladstone	291,374
Croxton to Suffern	32,489,524
Suffern to Sparkill	1,010,510
NJNYE to Nanuet	5,910,132
Hoboken to Rdgwd. Jct.	10,842,677
Summit to Denville	2,250,180
Newark to Montclair	259,257
Hoboken to Ptrsn Jct.	4,419,430

* If D exceeds X for any segment, the price for that segment is simply zero.

We recognize that these estimates are imprecise. In addition to the reasons previously noted, a number of problems arise from using revenue estimates and variable cost ratios that are derived from historic information and do not reflect various adjustments

to the EL-LV pro formas noted elsewhere in the opinion. Our conclusion that the EL-LV figures overstate earnings values of the main freight lines because trackage rights fees for use of publicly owned passenger lines are understated, see pp. 244-51, *infra*, provides one example. Higher trackage rights fees imply a lower earnings value for traffic moving over the passenger lines, and thus lower values for D. Allowances for the labor protection costs on the main freight lines, see Part IX, *supra*, would have a similar effect. Beyond this, if EL had decided to abandon a passenger line because D exceeded X, this would entail further labor protection costs. Since, although the GPs devoted significant attention to the theory behind the deduction argument, neither party considered the issues arising in attempts to quantify its magnitude, we rest with the above figures as a fair approximation rather than attempting further refinement.

5. *Trackage Rights Fees*

EL's argument that "the State, once having acquired the commuter lines, would have granted the necessary trackage rights to the solvent acquirers", ELP at 17 n.14, neither addresses the question of what fee would have been charged nor indicates what assumption concerning acquisition price is implicit in the proffered testimony. The EL-LV pro formas are based on the assumption that the public body would have charged a solvent acquirer the avoidable maintenance cost for freight movements over passenger lines.[273] In sharp contrast, the GPs contend that public bodies would have included common costs, rehabilitation costs, and acquisition costs in the trackage rights fee. The GPs further argue that trackage rights fees would have been set to recoup from acquirers of the Ts' main freight lines as much of the new financial burden on public bodies as possible, attempting to share in the earnings values contributed to the main freight lines by the passenger lines. We find substantial merit in some but not all of the GPs' criticisms, and conclude that public bodies would

have computed trackage rights charges based upon an allocated cost formula that covered charges for both maintenance of way and rehabilitation, but not the acquisition cost itself.

First, it is necessary to determine the overall formula that a public body would have applied. The GPs present a number of cases where public bodies successfully resisted increasing passenger subsidies to cover anything more than the avoidable cost of the passenger operations. See, *e.g.*, Whitehurst (S) (Jan. 30, 1980) at 14 (New Jersey and PC), 17-18 (New Jersey and CNJ); Stangl (S) (Nov. 1, 1979) at 17 (New Jersey's historical unwillingness to pay any "freight costs" on the passenger lines). And the testimony of public body officials confirmed that these principles would have continued to govern decisions in the alternative scenario. See Altshuler (S) (Nov. 1, 1979) at 28-29; Stangl (S) (Nov. 1, 1979) at 21-22; Whitehurst (S) (Jan. 30, 1980) at 52-53. The Ts do not offer proof to the contrary. However, the GPs, despite their evidence, based all of their projections upon an allocated cost formula. See, *e.g.*, Government Parties' Response to Court's Letter of August 28, 1981 (Sept. 14, 1981) at 24 & n.18, Sp. Ct. Rep. at N 36879. Since this formula is both easier to compute and accords better with a sense of fairness in light of the heavy passenger traffic on these lines, it seems more likely than any other to have governed negotiations in the alternative scenario.

Deciding that the trackage rights fee would be based upon an allocated cost formula does not end our inquiry since there are countless theories upon which to base the allocation. Passenger traffic requires track to be maintained at a higher level than is necessary for freight both because frequent, moderate delays that may be of little consequence to freight movements can be a major disruption for commuter service and because passenger trains operate at higher speeds. On the other hand, in considering the level of necessary maintenance for heavy density freight lines (over 5 million gross tons per mile), Jackman, on behalf of the JTTs, assumed that track conditions should permit movements at

50 mph. Jackman (S) (JT) (Dec. 15, 1978) at 3. Since freight traffic is significantly in excess of 5 million gross tons per mile on the Boonton line, and very near that level on the Suffern line, GP's Sept. 14, 1981 Response, Table A, Sp. Ct. Rep. at N 36883, it cannot be said that most maintenance on EL's passenger lines is required only because of the existence of commuter traffic. Moreover, since freight cars are heavier, they cause more wear regardless of the level to which track must be maintained. For example, the presence of significant freight traffic would make it necessary to lay heavier rail and replace it more frequently. This is presumably the basis for the ICC's formula that allocates costs based upon gross ton miles. In fact, a gross ton mile formula was used to determine B&M's share of maintenance costs over its passenger-carrying lines that were acquired by the MBTA. See 2 CRA (S) (Dec. 1, 1978) at VI 63. Still, given the added requirements of passenger traffic, EL's witness' contention that allocation on a gross ton mile basis is unfair, Shannon (D) (May 22, 1979) at 250, EL App. N, at 78, has some force. We believe that the most reasonable allocation and the one that would have been agreed upon in negotiations between public bodies, the Ts, and acquiring railroads in the alternative scenario is a formula based upon car-miles. It is more generous to freight than the gross-ton-mile formula used by the ICC or the avoidable cost passenger formula that is supported by the GPs' witnesses although not advanced by the GPs themselves, but reflects more reasonably than either of the other two formulas the additional maintenance required for passenger traffic.

That the trackage rights fee would cover regular maintenance expenses is not disputed. The Ts assume, however, that rehabilitation would not be included. Yet no reasoning or evidence is offered in support of their position. As revealed in our discussion of rehabilitation expenses in Part VIII, the distinction between maintenance and rehabilitation is somewhat artificial. See pp. 86-87, *supra*. Rehabilitation is necessary when regular maintenance has lapsed. Both expenses are necessary to make the line

suitable for carrying traffic. It would be ironic for the Ts to avoid completely the burden of rehabilitating passenger lines that are necessary for their freight movements when their failure to keep them in adequate condition in past years caused their current condition.

At some points, the GPs argue that acquisition costs should be covered as well. Over lines for which D exceeds X, we have already concluded that the acquisition price would be near zero, so there is no acquisition cost to recoup. As to the others, where X exceeds D, inclusion of acquisition costs in the trackage rights fee would make little difference. We have already demonstrated that the earnings values attributable to publicly acquired lines, D, would be deducted from X in setting the purchase price while the Ts would have sold the main freight lines to solvent acquirers for the full amount of earnings values, see pp. 231-33, *supra*. Were the public to charge a trackage rights fee set to recover any portion of the acquisition cost, the value of the freight lines and thus the price any solvent railroad would have been willing to pay in acquiring them would be reduced by the same amount.[274] As a result, the acquisition price for the passenger lines must be reconsidered. Since that price equalled X minus D, every dollar by which D decreases leads to a one dollar increase in the price the public must pay. D represents the maximum that public bodies could extract through any combination of trackage rights fees and deductions from the purchase price for the passenger lines. On lines for which X exceeds D, the public has already extracted the maximum amount possible in setting the purchase price.[275]

It is more plausible to assume that D would have been deducted from X in setting the purchase price for the passenger lines than to assume that the public would have paid more for the lines and charged the difference in trackage rights fees. First, on lines for which D is less than X, a trackage rights fee set to recoup the full purchase price would, for the reasons noted above, induce the acquirer to cease operations over such lines since the trackage

rights charge would be in excess of the earnings value contribution of the traffic. As a result, to recover D through trackage rights fees reflecting acquisition costs, the fees would have to vary line-by-line to reflect differences in the ratio of D to X on each line, an unduly complex and unlikely arrangement. Second, higher trackage rights fees induce freight users to eliminate marginally profitable movements and divert others. It is more efficient, therefore, both in terms of resource allocation and collecting the maximum amount of revenue, for the public body to recoup D in a lump sum through a deduction from X in setting the acquisition price than through a usage charge reflecting acquisition costs.[276] Thus we have chosen to apply deductions to the acquisition price for the passenger lines and to exclude acquisition costs from trackage rights fees.

A final possibility that must be addressed is the GPs' suggestion that public bodies would use trackage fees to extract any additional earnings value. As noted previously, since acquisition price already reflects a deduction from X, the only lines over which any additional extraction would be possible are those having D in excess of X. But those lines would already be selling at a price near zero, and freight is already hypothesized to be bearing its share of maintenance and rehabilitation costs. Thus, if public bodies proposed trackage rights fees that were any higher, the Ts would simply have included the lines for which D exceeds X in the freight sale package, leaving the public bodies with the burden of conducting passenger service. We indicated previously that, for scheduling reasons and because of the ability to control maintenance more directly, public bodies would presumably have had a preference for ownership, especially since they inevitably would have owned the other passenger lines in the alternative scenario. But if the threat of excessive trackage rights fees were serious, there is no reason to doubt that those passenger lines that contributed in excess of their X to earnings value would have been privately acquired, with the public left to conduct passenger operations. Since none of the GPs' evidence suggest that the public

would attempt to go so far, apparently against its own interest, we continue to assume that New Jersey would have acquired all of EL's passenger lines.

All that remains is to compute the trackage rights fee. Our letter of Sept. 24, 1981, Sp. Ct. Rep. N 37178, requested the parties to provide information concerning trackage rights charges and maintenance of way and rehabilitation costs on the predominantly passenger lines because the briefs devoted virtually no attention to this issue. The parties' replies continued a heated controversy over the level of maintenance of way costs on the passenger lines and the proper allocation of these costs between freight and passenger users. In Part VIII we indicated why we find EL's maintenance of way figures more reliable than those presented by the GPs, see pp. 83-89, *supra*. Since there is sufficient evidence in the record to estimate maintenance of way costs on the passenger lines based upon EL's studies, we use them here as well.

We have no reason to question EL's figure of $1,987,000 for maintenance of way costs attributable to passenger service, which is taken from EL's Form R-1 for 1973. EL attributes $2,788,000 of its freight maintenance of way costs to freight traffic on the passenger lines. The figure is based upon the average system freight maintenance of way cost per equated track mile, which was multiplied by the number of equated track miles of the passenger line. See EL's Oct. 7, 1981, Response at 9 & nn.8-10, Sp. Ct. Rep. at N 37262. The GPs question the accuracy of such an approach, GPs' Oct. 7, 1981, Response at 9, Sp. Ct. Rep. at N 37241, but do not prove that the result is too low. EL's method provides a reasonable, although very rough, estimate, which we accept as the best available.

We have rejected Shannon's conclusion that freight's share of this $4,775,000 total is merely $733,000. See note 273, *supra*. We also are not persuaded by EL's repeated assertion that Shannon's figure is reasonable on the ground that the approximately $4,000,000 share it assigns to the State of New Jersey is a lesser

burden than the $4,300,000 assumed by the State in 1973 under its avoidable cost subsidy arrangement with EL. First, the evidence does not indicate the total maintenance of way cost or allocation formula upon which the $4,300,000 figure was based. The GPs are correct that it defies belief that passenger avoidable costs were approximately 90 percent of the total maintenance of way costs on these lines. EL's position also is hard to reconcile with its $2,788,000 figure for freight maintenance of way costs. In fact, EL refers to this figure as "the cost of maintaining the line for freight service," EL's Oct. 7, 1981, Response at 12, Sp. Ct. Rep. at N 37275; hence passenger avoidable costs for maintenance by definition must be at least $2,788,000 less than the total maintenance of way costs for these lines. Second, none of the evidence presented proves that the State actually paid $4,300,000 in 1973. The figure is taken from a study prepared for the State that arrived at a figure of $12,742,000 as EL's passenger deficit for 1973. EL App. O at 23-66. Yet other evidence relied upon EL demonstrates that in 1973 the State's subsidy payment was only $9,106,000. Ex. ELR-NJ-1 at 225, ELP at 16. Third, the GPs are correct in noting that "EL's position that no acquirer of its main freight lines would have acquired the 'predominantly passenger' lines (EL October 7 Response at 25) cannot be reconciled with EL's simultaneous contention that under its scheme passenger service would cost *less* than New Jersey paid under the 1973 contract. See *id.* at 3." GPs' Oct. 14, 1981, Response at 8, Sp. Ct. Rep. at N 37360. We therefore conclude that the most reasonable estimate of the maintenance of way component of the trackage rights fee New Jersey would have charged can be computed by directly considering our best estimate of the total maintenance of way costs on the predominantly passenger lines and allocating that cost based upon car miles of traffic.

The $4,775,000 figure must be adjusted to normalize the level of maintenance, which adds $133,650 to the total, see workpapers ELR 300 206165 (revised), Workpapers to Memorandum of the Erie Lackawanna Trustees in Response to the Court's Letter of

June 19, 1981 (July 10, 1981) at 30, yielding a total of $4,908,650. There seems to be little dispute that freight traffic constituted 56.2 percent of the total movements over EL's predominantly passenger lines on a car mile basis, see GPs' Sept. 14, 1981, Response at 25, Sp. Ct. Rep. at N 36880, which yields an annual charge of $2,758,661 to cover maintenance of way expenses.[277]

A further adjustment must be made to account for freight's share of other costs related to operation of the passenger lines. See GPs' Oct. 7, 1981, Response at 12 n.10, Sp. Ct. Rep. at N 37244.[278] The GPs indicate that they did not separately compute an appropriate figure, *id.*, so we must rely upon the only available estimate, which is that computed by Jennison in the context of the JT studies. The relevant figure is $.02199 per car mile, Jennison (S) (JT) (Dec. 15, 1978) at 33-35, which we multiply by the number of freight car miles, 15,426,404, Workpaper to EL's Sept. 21, 1981 Response, yielding an addition to the trackage rights charge of $339,227. The total annual charge is thus $3,097,888 not the $733,000 included by EL.

The solvent acquirer of EL's freight lines must also pay for its share of rehabilitation costs. We accept Shannon's overall estimate of these costs subject to the few minor adjustments noted in Part VIII and believe that an acquirer of EL's and LV's main freight lines would have paid 56.2 percent of the total cost of rehabilitation. The acquirer might have paid this amount to the public body as a one-time trackage rights assessment or might have performed the work itself and been reimbursed by the public body for its share of the bill.

XII. Proffers of Freight Lines at Capitalized Earnings—Issues Not Heretofore Considered

In this Part we consider a number of questions relating to proffers of freight lines at capitalized earnings with which we have not previously dealt. The largest portion of this Part will

relate to the EL-LV combination. We shall then pass on to AA and L&NE.

A. *The EL-LV Combination*

As indicated in Part II, EL believed that of the possible acquisitions proffered by it, the most attractive would be a combination of its main line with LV's line from Waverly, New York, to Northern New Jersey. LV's witnesses agreed that this also was the best disposition for itself. We agree with these positions.

The advantages of this combination would have been great. As discussed elsewhere, see Part II, both EL and LV had lines running from the NJ Terminal area to Buffalo. EL's main line continued on from Hornell, New York to Chicago. Almost 85 percent of LV's traffic originated or terminated on its lines between Sayre, Pennsylvania, near Waverly, New York, and the New Jersey terminal area, with only 15 percent of its originated or terminated traffic on the 172.6 mile line from Sayre to Buffalo. EL's line from Binghamton, New York, through Scranton, Pennsylvania, to the New Jersey terminal area generated less traffic than its line through Port Jervis and Suffern, New York, and almost all that was generated on the Scranton line could have been diverted to LV's parallel line from Waverly to Oak Island Yard near Newark. By abandoning EL's Scranton line and LV's route from Ithaca, New York, to Buffalo and routing the traffic of EL's Scranton line over LV's line and LV's traffic to and from points west of Waverly over EL's lines to Buffalo and Chicago, an acquirer could

> create a rail system with a compact network of rail lines, a relatively simple route structure, well clustered industry, and extremely high traffic densities.

Adik (S) (EL) (Dec. 31, 1978) at 4. Both Adik and Shannon testified that potential acquirers of EL's and LV's lines would have viewed this routing as extremely desirable and no GPs' witness disputed them on this point. See *id.*; Shannon (S) (EL)

CONTINUED IN VOLUME II